AMERICAN COMMERCIAL CREDITS

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FOREWORD

There is nothing more interesting than to watch the first development of a child and its rapid growth into full manhood; it is fascinating even to follow his first struggles in overcoming children's diseases. For those actively connected with the establishment and development of the federal reserve system, it has been a thrilling spectacle to see it grow up so rapidly, turning into a full-size giant who today is surprising the world.

It is difficult for us to realize how radical the change in American banking psychology has been since the enactment of the Federal Reserve Act. When in 1914 the power to extend credits by the granting of bankers' acceptances was given to national banks, the majority of our leading bankers looked askance upon this new privilege, and some of them, indeed not the smallest amongst them, stated in no uncertain terms that as far as their bank was concerned it would never avail itself of this power. The result was that for the year 1914, open-market purchases by federal reserve banks was insignificant; by the end of 1915 it did not exceed $65,000,000; and by the end of 1916 it had reached $385,000,000, still a comparatively small figure for a country of the vast resources of ours.

During all these years officials of the federal reserve system kept on preaching the gospel of bankers' acceptance credits, trying to persuade banks to do their part in supplanting foreign acceptance credits by those issued by our own banks. Real headway in this regard was made only in 1917 when the formation of large acceptance credit syndicates began to popularize acceptance banking amongst

American banks. Matters then took a turn which is fairly characteristic of our country. Banks suddenly went from one extreme to the other. They became so eager to put out their acceptances, so anxious to earn commissions which came to them so easily without involving their own loanable funds, that many of them apparently overlooked the risks connected with the granting of every credit, be it a cash or an acceptance credit; and with the boom period following the Armistice the aggregate of bankers' acceptances outstanding in the United States soon soared to an amount estimated at one billion dollars, while the federal reserve banks' open-market purchases of 1920 totaled $3,200,000,000.

Then came the collapse of inflated prices, and with it the wave of cancellations and the epidemic of dishonoring existing contracts and pledges. It then became evident how poorly prepared and equipped quite a number of accepting banks had been which had extended acceptance credits, so-called letters of credit, confirmed or unconfirmed, in all parts of the world. In times of prosperity people generally lived up to their contracts without seeking for loopholes through which they might escape their obligations. It is different in times of adversity; and events soon proved with ominous conclusiveness that the loose system under which these banks had operated offered all kinds of holes through which a slippery customer might escape, or in any case find a sufficient pretext to claim the right to evade his contract. It is true that not only did these conditions exist in the United States, but that all over the world similar difficulties arose. Where unscrupulous buyers declined to honor their obligations, taking refuge behind some technical plea of non-compliance on the part of the shippers, or where shippers indulged in sharp prac-

tices, the accepting banks were placed in the fatal position that by living up to their obligations, given in behalf of the customers, they would lose all recourse against the customers in case the courts should sustain the latter's technical objections, no matter how frivolous and disreputable those objections would appear to the accepting banks. This in turn brought about the unheard-of condition that the seller who had shipped the goods on the strength of a confirmed credit opened by a reputable bank, or a third party who had negotiated the credit in good faith, found the accepting banks going back on their sacred obligations.

To those deeply concerned in the future of American banking it became obvious that steps would have to be taken to render impossible recurrences of this sort. For, if permitted to continue, this lax observance of contracts would destroy the very confidence upon which letter of credit business must rest and force us back upon the primitive and wasteful basis of cash dealings, unless, indeed, other countries, particularly England, were to master the difficulties and find ways and means to open letters of credit in a way that would command the patronage of the traders and shippers all over the world, including our own.

Considerations of this sort brought into life the so-called "Commercial Credit Conference" which bent its efforts on securing the adoption of a uniform terminology in dealing with letters of credit and on devising credit instruments which would be proof against the uncertainties that had led to the disasterous confusion of 1919. The thought that moved this "Commercial Credit Conference" was that bankers, purchasers, and sellers could reach a common agreement with regard to a uniform method of interpretation and a basis could be developed upon which American bankers could open letters of credit in safety

and keep the reputation of dollar acceptances untarnished in all the markets of the world. The American Acceptance Council was keenly interested in this work and joined forces with the Commercial Credit Conference, particularly in using its influence with the leading American banks to bring into effect a common plan of co-operation.

American acceptance banking has now grown to full manhood. It has safely passed through an acute stage of a vicious children's disease. If we may hope with confidence that in the future the American letter of credit business will develop on a solid foundation without being exposed to the vicissitudes of the past, the banking and business community owes a debt of gratitude to the Commercial Credit Conference, and particularly to its chairman, Mr. Ward.

America's new reserve banking system can only reach its fullest development and highest efficiency if we succeed in constructing as its foundation a discount market as wide and important as that of London. This can only be accomplished through the development to its utmost possibilities of the art of making and marketing American bankers' acceptances. It is the first requisite of a bankers' acceptance that it should be as good as gold and that there cannot be any vestige of a doubt as to its validity.

Whatever is done in removing any obstacles standing in the way of the achievement of these ends, is a distinct service to the country.

In recording the history of the epidemic of 1919 and in teaching the prophylactics required in order to avoid its recurrence, Mr. Ward's book will prove itself a contribution of a genuinely constructive order.

PAUL M. WARBURG

PREFACE

Knowledge on the part of American bankers of the intricacies of the commercial letter of credit business has scarcely kept pace with the growth of the use of the instrument. The expansion of this business was inevitably involved in that of the bank acceptance, the use of which, first permitted in 1914, had, by 1920, reached proportions exceeding those contemplated by its advocates. While, however, the more common employment of the letter of credit had made bankers familiar with its general aspects, intimate knowledge of commercial credit business was confined to subordinate officials in charge of the commercial credit departments of our credit-opening banks.

The business depression of 1920 brought about a realization of the fact that there would have to be a broader understanding of the instrument if its use were to be continued by American bankers without loss of their standing before the rest of the world. It was appreciated that bankers would have to be more careful in observing the obligations they assumed under credits opened by them. The lack of uniformity of commercial credit practice in some instances, moreover, had placed our credit-opening banks in a position in which the substantial fulfilment of their obligations, despite technical considerations, created grave issues with country banks or importing houses, which did not fully understand their rights and liabilities under the credits opened on their behalf.

One of the witnesses to this situation was Governor Strong of the New York Federal Reserve Bank, who was in the Far East during the height of the crisis in the sugar market. Mr. Strong has said that immediately

upon his return to the United States he called upon the principal officials of American banking institutions, and asked them whether they were aware of the serious nature of the action which had been taken by their institutions in connection with commercial credit transactions, and which had been interpreted by Far Eastern bankers as being nothing less than the attempted nullification of their credit obligations. He found that there was generally a lack of appreciation of the significance of their position.

A Commercial Credit Conference of American bankers was appointed in 1920 to search for a remedy for this situation. It has just now, at the conclusion of a two-year study, recommended a standardized practice, the adoption of which, it is hoped, will prevent a recurrence of the troubles. As the legal and banking literature of Great Britain and the Continent contained little mention of the subject it was necessary for the Conference to study actual practices, to examine the instruments of the leading international banks, and to discuss problems and theories with the men who were actually engaged in handling commercial credit transactions. The information thus gained had then to be subjected to analysis by students of the technique of foreign banking and foreign trade, and their conclusions had in turn to be tested from the legal aspect by bank counsel.

The purpose of this book is to make generally available, not alone the Conference's conclusions and recommendations, but an explanation of commercial credit practice, a representative selection of typical credit instructions, and a summary of the leading precedents, sufficient to enable bankers, merchants, and lawyers to gain a true understanding of the practical procedure connected with commercial credit operations and of the legal relationships of the parties to the transactions.

It is a pleasure to acknowledge the debt which the author in common with all who desire to see the United States maintain its position as a center of international finance, owes to the scholarly researches of Karl Nickerson Llewellyn, Chester B. McLaughlin, Jr., and to Carl A. Mead, the last mentioned of whom has contributed to this book the chapters on the legal aspect of commercial letters of credit.

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AMERICAN COMMERCIAL CREDITS

INTRODUCTION

The interest of American business men in the subject of commercial letters of credit is very widespread, but it is of comparatively recent date. Prior to the Great War, though our export trade showed a gratifying increase from decade to decade, it was overshadowed by that of the world's great market place—Europe. England, Germany, and France were in the nature of gigantic department stores, equipped with highly organized systems for the communication of orders, the delivery of merchandise, and the extension of credit. The United States until 1914 conducted a "cash and carry" business on a side street.

In specialties, such as steel, typewriters, cash-registers, talking machines, automobiles, shoes, hardware, and cameras, our skill as overseas traders equaled that of the best exporters in the world. However, the great majority of our manufactures still had to learn how the success of their compatriots had been achieved when in 1914 the European "storekeepers" fell out. Presently the neutral customers of these European storekeepers found them too busily engaged in their quarrel to attend to business. They quickly came, then, to America in search of many articles which had never before entered into our export trade. And while we were trying our best to meet this unexpected demand, the European shopkeepers found themselves consuming their own stocks more rapidly than they could replenish them, and joined the crowd which surged at our door. It was then that interest in commercial letters of credit became intense and general in this country.

Commercial letters of credit as such were not new

devices in 1914. They had for a generation at least been a favorite method with European merchants, particularly the British, in financing importations of raw materials from this and other countries. In this way their usefulness had impressed itself upon American sellers of goods even before the war. They already were employed to a limited extent by our own merchants, who, in bidding for the products of the Far East and other markets where they came into competition with European importers, were compelled to offer the same mode of payment as was offered by the Europeans.

Commercial letters of credit were then, however, practically unknown, to domestic traders, who had, since Civil War days, largely sold on open account. Under the open-account system the seller delivers the merchandise to the buyer and extends him credit on book account. He is without security and has no self-proving evidence of the debt; moreover under this method his capital, or the money he borrows, is tied up in the goods until they are paid for. There had been a growing feeling, even among domestic traders in the United States, that the open-account system did not permit the building up of a solid domestic credit structure, and when the war broke out it was obvious that the system would not do at all for our new foreign trade.

The American merchant was not ready to extend credit to a foreigner on open account without security and thus tie up his capital until the merchandise had arrived overseas and been disposed of. Where he had confidence in the foreign buyer, the American seller might be ready to draw on him, with documents attached, to be surrendered against payment, or acceptance, of the draft. But most American merchants in 1914 were dealing with new customers. Confidence was not established; credit infor-

mation on foreign names was not generally available; and political and economic conditions were changing rapidly. So the American merchant felt justified, as a general rule, in expecting payment for his merchandise before it left this country. And commercial letters of credit came to be the instruments employed for this purpose, because they were readily adapted to affording cash to the seller in exchange for the shipping documents. They came, therefore, into general use in our export trade beginning with 1914. Their employment in our import trade expanded with like rapidity, and within a year or two they made their appearance in domestic trade as well.

If commercial letters of credit, in the few years which have elapsed since their general introduction into our domestic and foreign trade, had come to be completely understood, their legal nature thoroughly defined, and their possibilities wholly appreciated, interest in them as an object of study would be limited to a few specialists, and they would scarcely need an historian. None of these things, however, has occurred. As was naturally to be expected, due to the abnormal and chaotic conditions that led to their more general adoption in this country, commercial letters of credit have been largely used without being thoroughly understood. Thus the curious situations which have arisen as a consequence have intensified the interest in them as instruments of finance.

American bankers have for the past two years given the subject intensive study, so that the commercial letter of credit instruments issued in the future may clearly indicate the obligations intended, and that commercial credit practices may become more uniform. Lawyers are seeking to familiarize themselves with the subject, both to assist their clients out of difficulties into which they have fallen because of the present lack of understanding, and to

counsel them how to avoid these pitfalls in the future. And merchants are coming to appreciate that commercial letters of credit, properly understood and intelligently utilized, will serve them better as a trade weapon than any legislative-born panacea.

From bankers, lawyers, and merchants alike, has come the suggestion that some effort be made to picture the commercial letter of credit business as it has grown in this country; to make a permanent record of problems which have developed with its use and of the solutions which have been made of these problems; and, above all, to seek out and discover, beneath the surface confusion, the basic principles which underlie commercial letter of credit operations. It is felt that if this is done both banking practice and legal decisions will in the future clarify and not obscure the fundamental simplicity which should give commercial letters of credit, rightly understood and intelligently employed, a usefulness far exceeding that which they have as yet had.

It is the privilege of one whose fortune it was to be in touch with the various aspects of the subject as it has developed in this country, to undertake this task.

CHAPTER I

THE RISE OF COMMERCIAL LETTERS OF CREDIT

Our Inheritance

The present and the future development of commercial letters of credit appears to rest in American hands; but for the story of their origin and past development we must look abroad. There is reason to believe that we shall, in the first decade of our widespread interest in the subject, contribute more to the development of commercial letters of credit than we have inherited from their centuries of slow growth elsewhere. To come, however, to a proper appreciation of the progress made since 1914, we must first turn backward, and survey the heritage which came under our ministration at that eventful time. But even before that we must define commercial letters of credit and indicate their place among instruments of finance.

Bill of Exhange

To indicate the extent to which a bank will give a customer money down, in exchange for his promise to repay it at a later date, there is fixed what is termed a "line of credit." The granting of a line of credit by a bank to a customer is tantamount to saying that the granting bank has evaluated the credit risk of its customer, and signifies its willingness to extend him the amount stipulated. This credit may be given either by handing the customer cash, or by putting the amount to the credit of his account,

subject to his checks. The customer is thus supplied with funds with which to purchase and pay at once for goods which he expects to resell at a higher price before the loan matures.

Such an arrangement may give the customer more than he needs. The merchant from whom he is buying may be content to make a present delivery of the goods in exchange for a satisfactory promise to pay at a later date. It was in response to the need for an instrument to serve as evidence of such a promise that the bill of exchange payable at a future date arose. It has been conjectured that the bill of exchange in its original form was a letter from a merchant in one country to his debtor, a merchant in another, requiring him to pay the debt to a third person who carried the letter and happened to be traveling to the place where the debtor resided.

The bill of exchange is made payable at a future date in order to give the merchant who receives the goods time to dispose of them and utilize the proceeds of his sale for the liquidation of the debt arising from his purchase. By accepting the bill on first presentation, the merchant receiving the goods acknowledges his obligation to pay cash at its maturity.

In the meantime the merchant who has sold the goods can, if he needs funds, offer the accepted bill to a note-broker for discount. The readiness with which such an acceptance is discounted depends largely upon the reputation and credit standing of the acceptor. If the buying merchant is unknown to the note-broker, his acceptance is not attractive and consequently is less useful to the selling merchant. As an alternative to paying cash for the goods, the buying merchant may find it cheaper, in case the selling merchant rejects his own acceptance as unsalable, to finance his purchase by paying a commission

to a better known merchant or banker to accept for him.

Commercial Letter of Credit Defined

It thus transpires that a bank can afford a customer a valuable facility, not alone by furnishing him cash, but by exchanging its own credit for that of the customer. That is, it can accept time bills of exchange drawn on itself, for account of the customer. And if it is prepared to do so, there is no good reason why it should not be ready to evidence this agreement in writing.

A buyer who can place in the hands of a seller a written instrument issued by the buyer's bank, authorizing the seller to draw in accordance with certain terms, and stipulating in legal form that all such bills will be honored, has at his command an instrument which will make his business more attractive to the seller than would otherwise be the case. An instrument by which a bank gives formal evidence of its willingness to undertake this class of operation for one of its customers is what has come to be known as a "commercial letter of credit." A commercial letter of credit is normally, though not necessarily, issued in favor of a third party, usually a seller of goods, designated by the customer on whose behalf the credit is issued.

As we shall see, commercial letters of credit are issued in a great variety of forms and are made available in a great many ways. The essential object in every case is the same—to evidence to a selected correspondent, or to bankers generally, the nature of the credit which the opening bank has committed itself to extend to its customer.

Antiquity of Commercial Letters of Credit

With their general nature understood, we can turn to the past history of commercial letters of credit. They

appear almost at the threshold of the history of banking. Their origin runs back to the early Roman and Lombard money-changers, to whom are also attributed the creation of bills of exchange. It would be reasonable, therefore, to suppose that these two instruments of finance, the letter of credit and the bill of exchange, had a parallel development. Bills of exchange and policies of marine insurance, which were both products of the same period, came under the observation of Lord Mansfield, who presided in the English Court of King's Bench from 1746 to 1758. This remarkable jurist, drawing on the wisdom of all the continental ordinances and codes existing in his day, and the practices and customs of the trade which he learned from special merchantile jurors, created the commercial law of modern England. There is no record, however, of any case involving a letter of credit having had his skilful interpretation. In fact, it is a matter of surprise that there has been until recently so little litigation about instruments which have been known and used for centuries. It is a tribute to the keen desire of bankers to honor their obligations without quibble, though it has contributed to the lack of understanding of the subject, that the use of commercial letters of credit has extended into these modern times without creating enough litigation, either in England or in this country, to define their legal implications.

Arrested Development

While commercial letters of credit are not a novelty either to continental banking or continental commercial law, their most extensive employment has been in England. Even there their general use appears to be confined largely to the present generation. For reasons which are somewhat obscure, commercial letters of credit, despite

their ancient origin, seem to have undergone several centuries of arrested development, while their contemporary instrument, the bill of exchange, has run a course which has resulted in the highly standardized and negotiable bills of the present day.

It is likely that one cause of this arrested development was that up to the present period, in which international banking has undergone great expansion, the acceptance of bills by proxy devolved upon the better known merchants, who in time found the commission for "lending their credit" to importers less well established, a source of revenue profitable enough to displace their original merchandise dealings. These houses were so few, their prestige was so great, and their ramifications so extensive, that their willingness to accept was established by a course of dealings, or by informal correspondence, rather than by the creation and issuance of formal commercial credit instruments. The idea of a written undertaking that bills to be drawn later would be honored was understood, and was not permitted to lapse. But it was not until comparatively modern times that the entrance of banks into the business of accepting bills, and the widened circle of merchants carrying on the increased volume of trade incident to present times, operated to cast the device into any fixed moulds.

Our Trade Financed by Foreign Agencies

Our own banking facilities were, until recently, occupied with the problems incident to internal development. This absorbed our wealth so completely that there was no surplus of liquid capital for employment abroad. In the meantime our foreign trade was rapidly growing from decade to decade. Its possibilities were not lost on foreign private banking houses and foreign colonial banks; they

quietly settled here and monopolized the field. The New York agency of the Canadian Bank of Commerce, for instance, was established in 1872; it was followed by that of the Merchants Bank of Canada in 1874. Both have since continuously engaged in the business of establishing import, and honoring export, letters of credit. These foreign banks possessed the experience, tradition, and organization that American banks naturally lacked, and they served our needs adequately and well. Their aid was absolutely essential. It takes not months but years and generations to train a nation to be the world's banker. It would have been an insurmountable task to have manned the foreign departments of American banks with efficient American staffs during this period.

Our Entry into Foreign Banking

It was inevitable, however, that at some stage in the formative period our pride would assert itself and that we should make a beginning toward building up purely American institutions to finance our share of the world's international trade.

In 1893 the Bank of New York, National Banking Association, following the decease of the local agent for some British banking institutions, took over the representation of these banks and thus became one of the first, if not the first, American national bank to engage in the issuance of commercial letters of credit. These credits were issued solely in connection with the importation of goods to this country and were invariably made available by drafts drawn in foreign currencies on foreign banking institutions.

Other American banks soon followed in this foreign trade financing. The London office of the Equitable Trust Company of New York was opened in 1895. The foreign

department of the National City Bank of New York was established in 1897, and the charter of the International Banking Corporation, which has since come under the ownership of the National City Bank of New York, was granted in 1901 by the state of Connecticut. In 1897 the Guaranty Trust Corporation of New York opened a foreign department and contemporaneously established a London office. The Bankers Trust Company has issued import credits since its establishment in 1903; the Chase National Bank began the issuance of import commercial credits in foreign currencies as early as 1905. In 1913 the Irving National Bank began the issuance of commercial letters of credit.

In New York the use of foreign currency credits, available by drafts on foreign banking institutions, to finance our importations, continued until 1915; and it was at this time that the use of dollar credits to finance our exportations began on an extensive scale. In Boston previous to 1913 national banks neither had a foreign department worthy of the name, nor were able to establish credits through their own foreign correspondents or negotiate export drafts direct. Such business as came into their hands was immediately turned over to old-established private banking houses with foreign connections.

The London Discount Market

It would carry us too far afield to trace all the causes which made London, in the period we are now considering, the world's financial center and the leading discount market. Suffice it to say that most of the time bills of exchange drawn in various countries against sales of goods in international trade found their way, with shipping documents attached, to London. They were drawn upon merchants, private banking houses, and bankers, and were

accepted by these establishments on behalf of their customers, who were the purchasers and the consignees of the merchandise and to whom the shipping documents were then usually surrendered. The accepted draft was sold by the holder on the strength of the high credit standing of the acceptor and upon any indorsements which the bills had accumulated. The purchaser was one of the private discount houses or bill-brokers, who in due course rediscounted the bill with a joint-stock or private bank, or with the Bank of England.

Commercial paper and bank acceptances formed the main assets, not only of London banks but also of banks in Paris and Berlin, where similar though smaller discount markets existed. These bills had the widest possible market and were exchanged daily in large volume at margins of $^1/_{16}$ to $^1/_8$ per cent in the interest rate. International money flowed to England for investment in this class of liquid paper at around 2 per cent. The persistent demand for London drafts resulted from the fact that they were the most readily salable in the various foreign markets. Our own importers and banks had to issue credits which provided the seller with a bill on London in order to make the bill salable. Whether they purchased in South America or in Asia, American merchants had to provide European bank acceptances and so paid an annual tribute of millions in acceptance commissions to European bankers for the financing of our trade. The acceptance of the American banker, no matter how good his credit, was valueless to foreign buyers.

The New York Discount Market

It was the lack of a discount market like that of London, Paris, or Berlin, which more than anything else made the acceptance of a New York bank useless as an instru-

ment of finance. This lack was in turn attributable in large measure to the character of American commercial paper. Causes which it is aside from our purpose to consider made the promissory note, instead of the trade and bank acceptance, the prevailing type of American paper. It was possible in a sense for a bank to mobilize the promissory notes it had discounted by offering them for rediscount to other banks, but there was a feeling that this action might be unfavorably construed. American commercial paper therefore remained unsalable and unliquid in character, because, being without the indorsement or acceptance of American banks of known repute, it was individual, provincial, and local in its investment appeal. It was usually distributed to the banks by note brokerage or commercial paper houses who purchased it from the makers. Once in the hands of the bankers, it remained there until maturity, even under pressure of such a demand for money as would result in the calling of stock exchange loans and the throwing of securities upon the market. Our national banks were not at that time permitted by law to accept time drafts. There was no obstacle to the acceptance of bills by private bankers, but the lack of anything approaching a discount market for these bills in New York was as effective as legal prohibition in keeping private bankers' acceptances from being created.

Passage of the Federal Reserve Act

The passage in 1913 of the Federal Reserve Act laid the basis upon which it was possible to develop in New York the sort of discount market that is indispensable to the creation of a center of international finance. The federal reserve banking system brought the gold reserves of the nation, which had previously been carried by the individual banks, into the federal reserve banks, and the

reserves of the member banks were carried primarily as credits on the books of the federal reserve banks. The secondary reserve of the member banks consisted of paper eligible for rediscount with the federal reserve banks. These latter institutions thus formed a great centralized reservoir of available mercantile credits, behind which stood the government and the national reserves.

In order to mobilize our mercantile credits, however, it was necessary to change the business habits of the nation by converting these credits from book accounts and promissory notes into trade acceptances. The ability of the national banks to finance foreign trade was assisted by authorizing them to accept bills having not over 6 months to run and growing out of the importation or exportation of goods. Such paper, having a maturity at the time of discount of not more than 90 days, was eligible for rediscount by the federal reserve banks, which, moreover, were authorized to purchase eligible acceptances in the open market with or without a member bank's indorsement.

The Inception of Dollar Letters of Credit

At the time the act became effective, it seemed unlikely that any very radical change would take place in the habit of our importers and bankers in resorting mostly to credits raised in London. It was believed comparative money market conditions and the universal popularity of sterling as a medium of exchange would continue to exert a compelling influence in favor of London. The continued exclusion of the domestic acceptance, together with the restrictions imposed upon the acceptance of international bills by regulations of the Federal Reserve Board, made it also appear likely that a general acceptance and discount market of the foreign type, including buyers and sellers who represented a wide variety of banking and financial in-

terests, would not be possible. All these calculations, however, were based upon an outlook for no more than normal progress in our export and import trade and naturally could take no account of the tremendous change which was to be brought about by the Great War.

The outbreak of the war terminated communication with the source from which a great many of the world's buying markets procured their merchandise and from which they also obtained facilities for financing. As the pressure of the war commenced to be felt the nations with whom communication remained uninterrupted found themselves more and more compelled to subordinate the requirements of their foreign customers to imperative domestic needs. These customers had therefore to seek a new source of supply and presently the United States became the world's greatest market place. The war brought overnight to the United States new and strange buyers, and introduced to the generality of our mercantile community novel exchange and shipping problems. This demand for our goods came at a time when the delicate machinery of international credit had been dislocated by the political and economic consequences of the war. The result was that many of our merchants demanded from buyers in every foreign trade center a device which would assure them immediate payment in dollars in exchange for shipping documents, as soon as the documents could be obtained.

Commercial letters of credit appeared to be suited to this purpose. And so, though they lacked uniformity of practice, though their legal effect was undetermined, and though our bankers and merchants were unversed in their use, an enormous volume of business came gradually to be done by means of these instruments. It is at this point that the story of American commercial credits properly begins.

CHAPTER II

AN OUTLINE OF OUR STUDY

Some Guide-Posts

It may as well be confessed at the outset that there is no well-worn path to tread in pursuing our subject. There is not even a blazed trail. Before us is virgin timber, which has grown with startling rapidity to unprecedented dimensions. Before we can enter it boldly, with confidence that we shall master its secrets and emerge safe and sound at our journey's end, we must arrange our plan of march. We shall, therefore, set up some guide-posts, not simply to be able to debouch, but also to enable us at any time to judge how far we have progressed, and the relation which the country we have traversed bears to the whole territory.

Haphazard Development

As we glance toward the terrain over which we must make our way, our first impression will be that of an inextricable confusion of false paths which lead nowhere. Some will be broad and smooth and well-placarded with signs by which a stranger may hope to keep his bearings; others will be narrow and devious and the guide-boards will remind one of those which Bob Burdette's Rollo encountered when learning to travel. When Rollo sought to learn why the finger-boards were painted so dimly, that wise man, his father, replied, "It is one of the traditions of the office to make them in this way."

"And do I turn down this road to the left, the way the

finger-board points, to go to Kickapoo Town?" asked Rollo.

"No," replied his father, "you go in exactly the opposite direction. That is another tradition of the office. You see, my son, the guide-boards are set up after this manner. The finger-board is nailed to the post in the shop, which is the barn of the supervisor. They are then loaded into a wagon and sent out on the road in charge of a man who cannot read. He is instructed to set a post at every road crossing, which he does, setting the post firmly and making a good job of it, without any reference to the direction in which the boards point."

So with commercial letters of credit. When we come to examine in detail the instruments which were employed to handle the enormous volume of our foreign business which came on the heels of the war, we shall see instruments, well adapted for one purpose, employed for others to which they were ill suited. We shall find that instruments which were in a general way adaptable lacked not simply uniformity in form and content, but certainty in their practical construction and legal scope and meaning. It was inevitable that in thus introducing an unfamiliar device wholesale into modern foreign trade financing, its defects as well as its virtues should manifest themselves. These defects were not inherent and inseparable, but resulted rather from some peculiarities of its development which prevented an orderly and systematic growth. These circumstances will here be briefly outlined. Subsequently they will be examined in detail.

The Conflict of Laws

It was essential to the development of standard forms of letters of credit that the variety of practical questions which hinge upon the legal theory to be applied to their

construction and interpretation should have a uniform solution. Yet the letter of credit developed in continental commercial law by giving effect to the mercantile idea that a promise made in the course of business was enforcible, while the English common law, on the other hand, reached the decision that a merchant's promise in writing made in a business transaction did not of itself suffice to create a legal obligation. As the use of commercial letters of credit was until recently confined almost wholly to overseas finance, it followed of necessity that they were usually issued in one country for use in another. The application of these conflicting laws of separate jurisdictions to identical instruments naturally threw the legal aspect of the subject into confusion. The minor part the commercial credit device played until recently in the world's commerce developed merely enough litigation to enable the English courts, as well as the continental, on one theory or another, to give them effectiveness, without working out a consistent legal theory which is the prelude to uniformity.

No International Standards of Commercial Practice

The commercial customs which are involved in international trade are, like the law, often in conflict. The buyer who stands at one end of a commercial credit and the seller who is at the other are bound to be influenced in their thoughts and expressions by the habits of the communities in which they live. For example, the same word may have quite a different meaning for each man. A ton is a ton—yet it is 2,240 pounds to an Englishman, 2,204 pounds to a Frenchman, and 2,000 pounds to an American. The same problem may have a different solution in different countries. It is the continental practice to regard an obligation which falls due on a Sunday or a holiday as maturing on the preceding business day; in America we

prefer it to mature on the following business day. This lack of common standards militated against the unification of commercial letters of credit through mercantile usage. To deal confidently and safely with an instrument in which such questions come up constantly for decision, there must be some reconcilement of the variant viewpoints. Yet in the vast volume of commercial credit business that came with the war demand for our goods, there was no definition of these trouble-breeding matters of commercial practice.

Confusion in Terminology

The international character of commercial letters of credit has brought about, in addition to the conflict of legal theory and the clash of commercial usages, a puzzling confusion of terminology about identical matters. And so as we journey on we shall, like Rollo, find strange names employed for familiar objects. Rollo thought, at one stage in his travels, that he was approaching a railroad crossing.

"It is not a railroad," replied his father, "it is a railway. What you call the tracks are not the tracks, but the line. And the rails are not the rails, but the metals. The yard engine is a shifting engine; the switch is a siding; we do not switch cars, we shunt them; the conductor is not the conductor, but the guard; the engineer is the driver; the fireman is the stoker; the ties are sleepers; the passenger car is a coach, the baggage car is the luggage van, and the baggage checks are the brawsses."

"But why are all these things other than what they are?" asked Rollo.

"Because it is English," replied his father.

No better reason can probably be given for the confusion in the terminology applied by the two main branches of the English-speaking race to certain types of credits.

The British define a "bankers' credit" as "an intimation by one bank to another that a merchant has opened a credit with them for bills to be drawn under the terms stated, without an undertaking by the bank in advance that it will give its acceptance to bills so drawn." A "confirmed bankers' credit," in the British view is one constituting an undertaking to accept. To the American banker these terms and definitions are alien. He calls a credit of the first type a "revocable" credit and of the second type an "irrevocable" credit, and limits the use of the term "confirm" to the act on the part of one bank of underwriting or guaranteeing the "irrevocable" credit of another bank.

The Consequences of Haphazard Development

The trouble-breeding consequences of this haphazard development of our commercial credit business did not immediately appear. So long as the war and postwar demand continued to exert an upward pressure on commodity prices, there was a general tendency to regard questions as to the interpretation of commercial credit instruments, which arose constantly, as incidents inseparable from commercial credit operations.

The sellers in whose favor credits were issued were usually successful in evading an issue on these matters by arguing that it was the duty of the banks to assist and not to impede the execution of the transactions they were engaged in financing. There consequently grew up a policy of liberal interpretation of instructions in the interest of the prompt movement of goods, which was effectual so long as the business situation continued favorable. But with the cessation of the demand for goods, buyers became critical of these interpretations, however well they were intended, if a stricter construction would save them from

the necessity of accepting a purchase which the turn of affairs had made unprofitable. There ensued a period in which cancellation of contracts and rejection of merchandise on technical grounds were resorted to by merchants everywhere. Bankers who had issued commercial letters of credit were instructed by their customers to reject documents if the least irregularity appeared. If the bank followed its customer's demand and refused to honor the drafts, it impaired the effectiveness of its commercial credit instruments in the future, because the information that the bank had shown a disposition to create difficulties would make foreign bankers unwilling to negotiate further drafts on the strength of its commercial credits. If the bank disregarded its customer's demand and honored the drafts, it preserved its good name but occasioned controversy and litigation with the customer. Thus all the possibilities for dispute which had been glossed over when business was favorable came up to plague the parties in controversy.

The First Step Toward a Solution

A difficulty that stood out above all others, because it was present in every overseas shipment, revolved around the question as to what constituted shipment and what was to be regarded as evidence of shipment. Before the days of steamship lines, with fleets of vessels and warehouse facilities at loading points, it was not usually possible for the vessel-owners or agents to receive cargo until the vessel was ready to load it. As the captain and mate were then at hand, the bill of lading was usually signed after the merchandise had been placed on board by one of these officials, who had prima facie authority to bind the owners in that respect. The bill of lading was therefore, as its name implies, a receipt for merchandise loaded on a named

vessel and a contract to carry it to the destination indicated.

With the development of modern lines it became the practice of steamship companies to receive merchandise on piers. There grew up, as a natural consequence, the custom of issuing, prior to the loading of the merchandise, a bill of lading signed by some clerk as agent for the owner of the vessel, which is known as the "received-for-shipment" bill of lading. So long as this custom was confined to strong companies with frequent sailings, its defects did not become apparent, particularly as reputable lines usually did not issue a bill of lading until the vessel which was expected to carry the merchandise had arrived in port. Nevertheless, the received-for-shipment bill of lading was in several respects quite different in its legal and practical effect from the old form of the so-called "shipped" or "on-board" bill of lading, which represented the merchandise as having been placed aboard a specified ship. The signature of an agent did not carry, as did that of the master or mate, prima facie evidence of his authority to bind the carrier. The absence of the designation of a specified vessel deprived the holder of the bill of lading of his right to attach the vessel in case the carrier failed to fulfil its obligation. The issuance of the bill of lading before the merchandise was loaded on board the vessel greatly broadened the period between the signing of the bill of lading and the arrival of the merchandise at the foreign port.

When new steamship lines with limited capital and infrequent sailings adopted the new form of bill of lading its vices quickly became manifest to buyers. On the other hand, it possessed a certain advantage to sellers, for it gave them a bill of lading as soon as the merchandise had been delivered into the custody of the steamship company.

Consequently, if this form of bill of lading was to be accepted as freely as the older form as evidence of the shipment of merchandise, sellers everywhere would benefit to the detriment of buyers. The result was natural enough. Merchants welcomed the new received-for-shipment form when they were exporters, and objected to it when they were importers. It was in the attempt to find some means of escape from the efforts of merchants to blow both hot and cold on this question, that New York bankers were induced to take measures for the solution of these problems.

The Conference of 1920

The first step was taken by several of the larger New York banks naming a committee to study the question. After conferring with representatives of the shipping interests, this committee worked out a plan which offered foreign buyers, on specific request, an on-board bill of lading, and which otherwise recognized the received-for-shipment bill of lading that had come into practically universal use not only here but abroad. Opportunity was taken at the same time to define some of the terms which were repeatedly used in commercial credit operations. The decisions of this conference were embodied in a pamphlet entitled "Regulations Affecting Export Commercial Credits Adopted by the New York Bankers Commercial Credit Conference of 1920." These regulations were subscribed to by 35 New York and Boston banks and the pamphlet was distributed by them to more than 30,000 correspondent institutions throughout the world.

Standard Forms Adopted

Contrary to the apprehensions of many, the regulations were favorably received abroad. This fact, as well as the

advantage of the protection they afforded all parties concerned against misunderstandings concerning matters that had previously been constantly in dispute, encouraged the belief that a comprehensive study of the subject might disclose a means of freeing commercial credit operations from the confusion which has been outlined. The ground work of this plan was undertaken with the co-operation of various foreign trade organizations by the same bankers' committee which had worked out the regulations of the previous year. The committee studied the question carefully from every angle and adopted certain standard forms which have the joint approval of mercantile and banking interests and which it is one of the purposes of this book to explain.

Recent Litigation

We have, as a heritage from the contract cancellations of the postwar period and the general haphazard development of our commercial credit business, a body of litigation involving the rights and duties of various parties to commercial letters of credit. These recent decisions are reviewed in later chapters to indicate the extent to which the basic principles which should govern the interpretation of commercial credits have been brought into the foreground.

Protection of the Mercantile Risk

Some of this recent litigation has firmly established the principle that the seller stands as beneficiary of a commercial letter of credit in a position quite distinct from his obligation under the contract of sale with the buyer—with the somewhat surprising result that the seller can violate the terms of the contract of sale and yet avail himself of his rights under the credit, if he complies with its terms.

The natural result is that the buyer seeks to prevent this contingency by inserting the contract of sale verbatim in the letter of credit. As a result, banks issuing credits for their customers are constantly put under pressure to insert provisions referring to the contract of sale, expressly or by implication, in whole or in part. The same banks, in buying bills or making payments under other banks' credits, seek the elimination of any reference to the contract of sale.

On the whole, banks find that the financing of an overseas purchase is a service which runs comfortably along usual banking channels, but the interpretation of sales contracts is not. To arrange for the scrutiny of documents and the examination of merchandise when delivered by the seller—that is, to ascertain whether he has duly performed his obligation under the contract of sale—is not a normal banking function. Some methods will therefore be proposed to relieve the banks of this task which they properly seek to avoid, and yet afford the buyer something more than the unsatisfactory remedy of a lawsuit against the seller to recover the money received in violation of the contract of sale.

The Purpose of This Book

It should prove to be an interesting, though to an extent a difficult journey, to take the trail and view the unfolding in detail of the territory which has now been mapped out. It may lend incentive to the venture to add that it is the purpose of this book, not simply to record past events but to point the way to the more beneficial use of the subject of its study. It is proposed to narrate the history of American credits, to make a record of the problems involving these credits, which have been considered and solved, to indicate the way in which our courts should

view the instruments, and to show the indispensable part they will play in the future development of our foreign trade. It is hoped that the present tendency to fit them into the hard and fast moulds of the common law of contracts may be stifled. Commercial letters of credit, despite their antiquity, have, as stated, suffered two centuries of arrested development. They have recently demonstrated their usefulness under modern conditions. They now need legal definition by the application of the same sagacious combination of the law merchant and the custom of merchants which has given us the Uniform Negotiable Instruments Law. The future development of commercial credit practice in this country, if the instruments are recognized as self-sufficient legal documents, will contribute to the law merchant a chapter as brilliant as the English courts have written for bills of exchange.

The Future of Commercial Credit Business

The advantages accruing from the various movements to make commercial credit operations move more smoothly come at an opportune time. The exhausted economic condition and the disturbed political state of most of the centers of international trade, render it more and more imperative that, if foreign business is to be conducted safely and economically, the extension of credit must be supervised and scrutinized by banks which are on the ground. The commercial credit device is peculiarly adapted to the attainment of their end. The measure of our export trade in the next few years will be the volume of commercial credit business that banks are willing to undertake. Let us, then, begin the examination of this instrument upon the use of which our export trade depends.

CHAPTER III

DEFINITION AND CLASSIFICATION

A General Definition

It has already been said that an instrument by which a banker, for account of a buyer, gives formal evidence to a seller of its willingness to permit him to draw on certain terms and stipulates in legal form that all such bills will be honored, is what has come to be known as a commercial letter of credit. The conventional method employed by authors of treatises on foreign trade to illustrate a commercial credit operation, is to use for an example a dollar credit issued by an American bank for an American buyer, directly to a foreign seller; say, for a Boston wool-buyer named John Doe, in favor of a Buenos Aires seller of that useful raw material, who is, for the sake of local color, named the Spanish equivalent of Richard Roe. This type of credit is perhaps the simplest to understand, particularly when it is regarded from the viewpoint of the American buyer, as he deals in dollars and there is no question of foreign exchange to complicate our comprehension. It will be well, therefore, to start at that point. However, the simplicity of that method of exposition would mislead us, unless we had already fixed in our minds the fact that there is no ideal type of commercial letter of credit, and that the virtue of any particular type depends entirely upon the purpose it is expected to perform and the conditions which confront the parties to it.

We must appreciate from the very outset the not unimportant fact that it is the fundamental simplicity

at the base of all commercial letter of credit operations and manifesting itself in several types of credits, suitable to varied conditions, which gives them effectiveness as trade weapons. To gain this appreciation, we must, before examining any particular type, ascertain what parties may become connected with a commercial letter of credit operation, the functions these parties perform, and the purposes they seek to accomplish.

Parties to Commercial Letters of Credit

1. The Accredited Buyer and the Beneficiary. The fundamental function of commercial letters of credit is to facilitate the marketing of merchandise. Their contribution to the process of distribution is made by putting the credit standing of the buyer at the disposal of the seller. The initiating party is of necessity the buyer, who is variously termed the "accredited buyer," the "importer," the "consignee," or the "account." The recipient is usually the seller, and is termed the "beneficiary," or the "accreditee." If the buyer's financial strength were sufficient to make it directly useful to the seller in offering his bills for discount, he might put it at the disposal of the seller by stating in writing that he would honor drafts drawn by the seller when accompanied by evidence of shipment in the shape of ocean bills of lading and of insurance certificates.

2. Opening Bank. It is not often, however, that a foreign buyer is sufficiently well known to make his own obligation suffice to enable the seller to obtain credit on its strength. To be effectual for that purpose, the promise to accept the drafts must be made, not by a buyer whose reputation may be only local, but by a person or concern enjoying widely known credit. So the buyer turns to some bank in his own locality, which has sufficient confidence

in him to extend him credit and which is sufficiently well known abroad to make its obligation, evidenced by a commercial letter of credit, a useful credit instrument when placed at the disposal of the seller.

There may be a second reason for bringing the buyer's bank into the transaction. The seller of goods to a distant country may feel a natural reluctance to extend credit to a buyer, because of the inherent difficulty of estimating and protecting credit at long range. In this case also the intervention of a third party, with a credit standing superior to the buyer, is necessary. This third party is logically the buyer's bank. The buyer's bank, which undertakes the credit for his account, is termed the "opening" bank. It may assist in indicating the direction and nature of the new relationships which are thus set up, to illustrate them graphically. We may identify the accredited buyer by the designation *A*, the beneficiary by the designation *B*, and the opening bank by the designation *O. B.* In this and subsequent diagrams we shall indicate the liability of the parties to each other by arrows, solid lines for direct liability, and broken lines for contingent liability. We also enclose each party incurring a liability in a box, and each party playing a neutral rôle in a circle. Our illustration will then take this form:

Figure 1. Relationship of Opening Bank (*O. B.*) to Buyer (*A*) and Beneficiary (*B*)

3. **Notifying Bank.** There is a choice of methods by which the opening bank may make such a credit available

to the beneficiary. The choice, as we shall later see more clearly, depends largely upon whether the credit is issued in the currency of the beneficiary or that of the accredited buyer. If the buyer's currency is the agreed medium of exchange, it is likely that the bank opening the credit will evidence its willingness to finance the transaction by a writing, addressed either to the beneficiary or to persons in general, in the expectation that some banker in the domicile of the beneficiary will be induced thereby to advance funds to him by negotiating his drafts drawn in accordance with the terms of the credit. The opening bank may prefer, however, not to notify the beneficiary of the existence of such a credit directly, but rather through the medium of a correspondent in the vicinity of the beneficiary. If the opening bank requests a correspondent bank to notify the beneficiary of the existence of the credit, the correspondent is termed the advising or the "notifying" bank.

As the notifying bank is simply a conduit for the passage of instructions, its entrance into the transaction creates no new credit relationship. In our graphic illustration we may identify the new party, the notifying bank, by the designation *No. B.* The relationship of the four parties will then take this form:

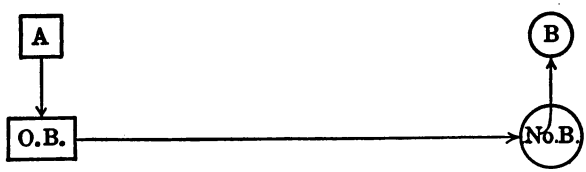

Figure 2. Relationship of Buyer (*A*), Opening Bank (*O. B.*), Notifying Bank (*No. B.*), and Beneficiary (*B*)

4. Negotiating Bank. If the notifying bank, or any other bank in the domicile of the beneficiary, is voluntarily

induced by the letter of credit to purchase the beneficiary's drafts, it is termed the "negotiating" bank. There is introduced, by the act of negotiation, a new credit relationship, both between the negotiating bank and the opening bank and between the negotiating bank and the beneficiary. The obligation in the latter relationship is a contingent liability which we shall indicate by a broken line but otherwise ignore for the moment, as we shall deal with it in Chapter XIII, "Recourse Against the Beneficiary." The opening bank has now become liable to the negotiating bank as a bona fide holder of the beneficiary's draft, in the same way that it is liable to the beneficiary as drawer. If we identify the negotiating bank by the designation *Ne. B.*, the relationship of the four parties concerned in this kind of credit transactions may be illustrated diagrammatically in the following manner:

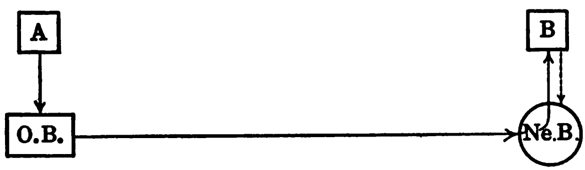

Figure 3. Relationship of Buyer (*A*). Opening Bank (*O. B.*), Negotiating Bank (*Ne. B.*), and Beneficiary (*B*)

5. Paying Bank. When, because the credit is issued in the currency of the beneficiary, or for some other cause, a correspondent in the domicile of the beneficiary is instructed to pay the beneficiary's drafts, usually drawn in local currency on itself, the correspondent is termed the "paying" bank. Of itself, the rôle of paying bank creates no credit relationship, either prior to payment or by the act of payment, if, as is normally the case, the payment is debited at once to an account maintained by the issuing bank with the paying bank. This neutral relationship is

like that of a notifying bank and requires no separate illustration.

If the correspondent is instructed not to pay the beneficiary's draft on itself but to negotiate the beneficiary's drafts on the opening bank or the accredited buyer, it is rather difficult to define completely the correspondent's position by a phrase. There is at present no general recognition of any principle by which to determine whether to apply to this rôle the term "negotiating" or "paying" bank. It seems logical and advisable, however, to confine the use of the term "negotiating" to a bank which advances funds to the beneficiary of its own volition, and to apply the term "paying" bank to a correspondent which either pays or advances funds to the beneficiary at the direct request of the opening bank. In this discussion, the term "paying" bank will therefore also be applied to a correspondent which negotiates the beneficiary's drafts under the opening bank's instructions.

6. Confirming Bank. In all the situations which have been thus far considered, the liability which has made the credit effective has originated from the buyer's bank, which is usually at a distance and in a foreign land. The beneficiary may prefer to be secured by the liability of a bank which is close at hand. If a correspondent of the opening bank in the vicinity of the beneficiary is instructed to hold itself out to the beneficiary as being responsible for payment of drafts drawn in accordance with its stipulations, it is called the "confirming" bank. If we identify the confirming bank by the designation *C. B.*, our illustration will take the form as shown in the diagram in Figure 4, page 35.

In this form of credit, in addition to having the direct obligation of the conferring bank, the beneficiary has the contingent liability of the opening bank, indicated in the

diagram by the broken line. It will be seen, as the subject is further developed, that one bank may fill several of the rôles just described.

Figure 4. Relationship of Buyer (*A*), Opening Bank (*O. B.*), Confirming Bank (*C. B.*), and Beneficiary (*B*)

Purposes of Commercial Letters of Credit

There will presently march past us a seemingly kaleidoscopic succession of commercial credit forms. On close inspection we will discover, however, that they differ—some merely in the manner of achieving the same purposes, and others in the purposes achieved. It will be well, therefore, at the outset to record the fact that a commercial letter of credit may serve one or several purposes, both for the beneficiary and for the accredited buyer. So far as the beneficiary is concerned, it always serves, in the first place, to enable him to finance the transaction during the transit of the merchandise. A seller who lacks sufficient financial strength to assemble merchandise and carry it through the period of transit to its destination, may find an all-sufficient purpose in a credit which enables him to undertake a foreign sale by utilizing the buyer's credit standing alone for that purpose.

If, however, the beneficiary is seeking a commercial credit for a second purpose—to obtain some better protection of the credit risk than is afforded by the buyer's promise to pay—he will require a credit in which an open-

ing bank, and preferably a confirming bank also, have added their commitment to the transaction. For the seller, then, a commercial credit serves the primary purpose of financing the shipment, and may serve a secondary purpose of safeguarding the credit risk.

The commercial letter of credit has also certain advantages for the buyer. It may afford him a means of using his purchase as security to obtain the credit necessary to finance the transaction. A documentary commercial letter of credit is automatically self-securing, because the opening bank's credit or funds are placed at the disposal of the beneficiary in exchange for negotiable shipping documents conveying control of the merchandise. For this reason the opening bank may be willing to issue such a letter of credit for a buyer to whom it would not willingly make a loan, without security, for an equivalent amount.

The second purpose of the letter of credit from the buyer's standpoint is to obtain the funds to finance the transaction in the cheapest market. Even where the question of security is unimportant, the use of the type of commercial letter of credit which provides that either the opening bank or its correspondent in some one of the world's money markets will accept the beneficiary's time drafts, will result in obtaining the funds to finance the trade at the most favorable rate, because the accepted draft will become "prime" paper, immediately salable in the discount market.

The same commercial letter of credit may be made then to serve four purposes: two for the seller—as a means of obtaining funds and as a security for payment; and two for the buyer—as a method of securing and of economically financing the transaction. Not all forms of commercial letters of credit serve all these purposes. The sort of

credit to be utilized depends, as will later be apparent, upon the purpose or purposes to be accomplished.

Difficulty of Classifying

Commercial letters of credit are as flexible as the minds of merchants are ingenious. There are no terms of sale to which they cannot be adapted. It must be borne in mind that the device is adaptable to an infinite variety of combinations, and that the general classifications which are made are intended to illustrate, rather than to limit, the possibilities of adaptation.

The lack of lucidity and comprehensiveness in most discussions of commercial letters of credit has resulted from the attempt to classify them as "import" and "export" credits. Every commercial credit is an export credit to the seller and an import credit to the buyer. The use of either term is not a classification, but the indication of a point of view. Analysis of any given commercial credit will disclose the fact that it may be classified in several ways—according to the method of transmission, the duration of the credit, the identity of the obligor, the method of payment, the method of reimbursement, and the provision for renewal. At any given time, because of existing market and exchange conditions, the credits demanded and received by a nation's exporters may differ with respect to one or more of the several features from the credits furnished to foreign sellers by the nation's importers; that is, however, a transitory circumstance which is without value for the purpose of analyzing the functions performed by the letter of credit. These functions must first be briefly defined, so that subsequently intelligent consideration can be given to the combinations of functions that the credit should perform to meet various circumstances.

1. Classification According to the Method of Transmission

Circular and Specially Advised. The opening bank has a choice of methods of transmitting the commercial letter of credit to the beneficiary. It may evidence its obligation by issuing a writing, addressed to persons in general, in which it undertakes to honor the beneficiary's drafts under certain stipulated conditions. This instrument may either be mailed by the issuing bank to the beneficiary or delivered by the issuing bank to the accredited buyer to be mailed by him to the beneficiary. In either event it is termed a "circular" letter of credit. This type of credit is illustrated by Figure 1 (page 31). The opening bank may choose, instead, to transmit the credit to the beneficiary through the medium of its correspondent in his vicinity. In that event it is usually contemplated that the payment or negotiation of the beneficiary's drafts will be undertaken by the notifying correspondent and such a credit is termed "specially-advised." It is illustrated by Figure 2 (page 32).

2. Classification According to Duration

Revocable and Irrevocable. If it is the intention of the opening bank to leave the duration of the credit open for subsequent consideration, and thus reserve the right to withdraw from the transaction, the credit will state that it is "good until canceled," or good until a stipulated date "unless sooner revoked," or some like phrase. Such a credit is termed "revocable." If it is the intention of the opening bank, on the contrary, to waive the right to cancel or revoke the credit prior to the date specified, unless the consent of the beneficiary is obtained, the credit will contain a statement to that effect and will be termed "irrevocable."

3. Classification According to Obligation

UNCONFIRMED AND CONFIRMED. If the notifying bank is merely requested to act as the medium through which the opening bank's obligation is transmitted to the beneficiary, its letter of advice does nothing more than guarantee, without any other obligation on its part, the authenticity of the message it is transmitting on behalf of its principal, the opening bank. Such a credit is termed an "unconfirmed" credit. If, however, the opening bank desires the notifying bank to give to the beneficiary its own assurance also that the opening bank's obligation will be performed, the notifying bank will not simply transmit but will *confirm* the opening bank's obligation by making it also its own undertaking, or commitment, or guaranty, or obligation, as one prefers to call it. It is illustrated by Figure 4 (page 35).

Such a credit is termed a "confirmed" credit under the accepted American usage of the term. It is not, however, in accord with British terminology. British banks, for reasons which will later be examined in detail and which are fundamentally historical rather than logical, use the term "unconfirmed," as synonymous with "revocable," and the term "confirmed," in conjunction with the word "bankers," as synonymous with "irrevocable." The term "confirmed" of itself has no greater significance, according to a recent British writer, than the word "advised," although he admits that some misinformed British bankers and merchants disagree with him on that point.[1]

4. Classification According to Method of Payment

(a) NEGOTIATION AND STRAIGHT. If the letter of credit is circular in form, its effectiveness is derived from

[1] W. F. Spalding, Bankers' Credits, London, 1921, p. 56.

the inducement it offers some banker in the domicile of the beneficiary to negotiate the beneficiary's drafts, either on the opening bank or some bank designated by it. If the drafts are to be drawn in the currency of the beneficiary's community, the only benefit the local negotiating bank will derive will be the interest and commission deducted from the drafts as a discount. If the drafts are to be drawn in a foreign currency, the negotiating bank will also derive a profit from the exchange rate applied by it to the conversion of the foreign currency in which the draft is drawn into the local currency, which the beneficiary requires for his local needs. Such a credit is in either event termed a "negotiation" credit. The relations of the parties are indicated by Figure 3 (page 33).

If the credit is specially advised, the notifying bank (if it is also made the paying bank under instructions from the opening bank) will either pay sight drafts on itself or else advance the face amount of the drafts drawn on some other drawee, usually the buyer. Such a credit is termed a "straight" credit. It is illustrated by Figure 2 (page 32). The essential difference between this credit and the negotiation credit is that in the latter instance the beneficiary, armed with the instrument, must seek out a bank which will be induced to negotiate his draft and must bear the cost of negotiation, while in the former instance the duty is put on the paying bank selected by the opening bank to furnish the funds to the beneficiary by paying his draft or advancing funds at the expense of the buyer.

(b) Sight and Acceptance. If the beneficiary's drafts are drawn at sight the credit is termed a "sight" credit. Once paid, the drafts serve simply as receipts for payment and are without value for any other purpose. If the accredited buyer and the opening bank want to use the drafts as a means by which to obtain funds for financing

the transaction out of a discount market, the credit will stipulate that the drafts be drawn at time, for acceptance, upon some well-reputed bank in a center of international finance. Such a credit is termed an "acceptance" credit. The draft is discounted after acceptance and the beneficiary is thereby immediately placed in funds, though the accredited buyer need not furnish funds to pay the draft until its maturity.

(c) Local Currency and Foreign Currency. A credit which stipulates that drafts are to be drawn in the currency of the domicile of the beneficiary is a "local currency" credit, while a credit which stipulates that drafts are to be drawn in a foreign currency, whether that of the accredited buyer or not, is a "foreign currency" credit.

5. Classification According to Method of Reimbursement

Simple and Reimbursement. Normally an opening bank which instructs a correspondent to act as the paying bank, under a commercial letter of credit, carries an account, in the currency to be paid, with the paying bank. The amount of the payment made to the beneficiary, plus the paying bank's commission for the service performed, is debited to this account. Such a credit is termed a "simple" credit.

Occasionally, however, the opening bank may not have an account with the correspondent it chooses as paying bank, or, having an account, may prefer, for reasons which will be discussed later, not to have it debted. In such case the paying bank will draw a draft for the amount of its payment, with commission and interest for the period elapsing until reimbursement, either on the opening bank or on a correspondent of the opening bank with which the opening bank carries an account. Such

a credit is termed a "reimbursement" credit. If we designate the paying bank by the initials, *P. B.*, the relationship of the parties to such a credit, during the interval between payment and reimbursement, is as represented in Figure 5:

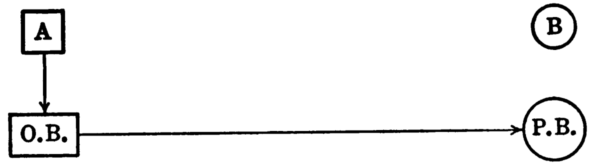

Figure 5. Relationship of Parties in a Reimbursement Credit

6. Classification According to Provision for Renewal

REVOLVING CREDITS—CUMULATIVE AND NON-CUMULATIVE. The opening bank may be willing to finance aggregate shipments which will exceed the amount of credit it is willing to have outstanding at one time for the accredited. Instead of issuing a credit for the amount to which it is prepared to commit itself and then establishing a new credit after the first has been exhausted and liquidated, a single commercial letter of credit may be given a life sufficient to cover the period of time necessary to complete the transaction, with the restriction that the amount of money named in the credit shall not exceed at any given time the limit set. This result is accomplished by limiting it to the amount agreed, with the proviso that upon notice from the opening bank that any draft which the beneficiary has drawn within that limit has been paid and retired by the accredited, a like sum becomes again available to the beneficiary. Such a credit is termed a "revolving" credit.

Sometimes the limitation is fixed by stipulating that the beneficiary may avail himself of not more than a

certain fixed amount within a given period, say one month, over a period of months. Such a credit it called a "monthly revolving" credit and should stipulate whether it is "non-cumulative," in which case any amount unused during the month lapses, or "cumulative," in which case amounts not used in one month are available in succeeding months.

Authority to Purchase

Akin in many respects to the commercial letter of credit and regarded by some as a true credit in revocable form, is the "authority to purchase." It is an authority given by a buyer to a seller to draw documentary drafts on the buyer, coupled with a request by the buyer to his bank to inform the seller of that fact and to arrange for the purchase of the drafts, which the buyer agrees to accept. The issuance of such an authority constitutes no engagement whatsoever on the part of the bank to the beneficiary, but indicates the belief of the bank that the drafts will be duly cared for by the buyer. If it may be regarded as a true credit in revocable form, the undertaking runs, not to the seller, but to the correspondent bank, and is an undertaking, not that the seller's drafts will be paid, but that the correspondent bank will be reimbursed for any outlay it makes thereunder. There has also been in use an anomalous instrument called a "confirmed irrevocable authority to purchase," which is to all intents and purposes a confirmed and irrevocable commercial letter of credit, differing only in the respect that the drafts are drawn, without recourse, on the buyer, instead of on the paying bank. The use of this latter instrument is now being replaced by the "confirmed irrevocable" letter of credit, which is a step in the interest of clarity.

Various Combinations

Now that we have acquainted ourselves with the designations of the parties to commercial letters of credit, learned what purposes these parties may be seeking to accomplish by the use of the instruments, and become aware of their basic classifications, we are prepared to survey the commercial letter of credit business as it developed in the United States after 1914.

CHAPTER IV

THE ABSENCE OF A STANDARD PRACTICE

American Banks Unprepared for Task

When foreign bankers set themselves to the task of supplying commercial letters of credit to the foreign purchasers who turned to the United States for goods as the doors of the European markets closed, they sought the intervention of the banks of the United States as notifying, paying, and negotiating banks. It was a novel task for them.

Previously, foreign merchants had bought elsewhere and had financed their purchases in London, Paris, or Berlin. So, too, had American merchants. The pound sterling has been the universally accepted medium of international exchange. It was natural that in business between England and her colonies and colonial possessions, buyer and seller should quote in that currency. But it did not stop there. If a wool merchant in Boston bought wool from Buenos Aires, the Bostonian might want to pay in dollars and the Argentinian to receive his payment in pesos. The Bostonian would have difficulty, however, in finding anyone in Boston who was in position to sell him pesos. The Argentinian, on the other hand, would have difficulty in finding anyone in Buenos Aires who needed dollars. The natural result was that both turned to a medium which was easily purchasable in Boston and readily salable in Buenos Aires. The Argentinian quoted in sterling and the Bostonian bought in sterling.

The universal popularity of sterling was not the sole reason why sterling credits were employed. The reputation of American banks did not at that time extend beyond our own borders. They were, for instance, so little known in Buenos Aires that the promise of an American bank that the Argentinian's draft would be honored on presentation to the London correspondent of the American bank might not be a sufficient inducement to Argentinian bankers to make the drafts freely negotiable. London bankers, on the other hand, were known by merchants and bankers everywhere and their promise to honor drafts was a sufficient inducement. Prior to 1914, over 95 per cent of American import credits were opened in sterling and advised to the beneficiary by London banks, which also accepted and paid the drafts for the account of the American bank. The part played by the American bank in these operations was simple indeed. Figure 6 reproduces a letter of the National City Bank of New York, which indicates that a brief cable to London completed, except for the exchange feature, the American bank's part in such a commercial operation. There was little, therefore, in the way of experience, custom, or practice to assist American banks in playing the new rôle imposed upon them by the war.

Foreign Practice Not Uniform

It would have taken a well-entrenched American commercial credit practice, in any event, to have prevented foreign bankers from pursuing the natural course of seeking to deal with us in the way that they had previously dealt elsewhere. Had there been anything approaching standard forms of commercial letters of credit and a uniform practice throughout the rest of

THE NATIONAL CITY BANK

OF NEW YORK

FOREIGN EXCHANGE DEPARTMENT

New York, January 5, 1900

Messrs. M. Guggenheim's Sons,
New York

Dear Sirs:

In accordance with the conversation we had this morning with your Mr. I. Guggenheim, we shall open a revolving credit in your behalf with the Deutsche Bank (Berlin) London Agency, London, by cable for £50,000.–/– as follows:

"Open a revolving credit in favor of Beeche & Co., Val-"paraiso, for £50,000.–/– for a/c of M. Guggenheim's "Sons, for payments to Cia Huanchaca de Bolivia, against "drafts @ 90 d/s without documents. Confirm by tele-"graph through Banco Aleman Transatlantico, Val-"paraiso"

and an additional revolving credit for £50,000.–/– on the same terms, conditions, etc., we shall open by mail, to be confirmed by letter or by cable from London.

You will oblige us by signing the enclosed Agreements and returning same to us in due course.

Yours truly,

....

Figure 6. South American Sterling Credit Opened through London

the world, our task would have been simpler and this discussion would have been shorter. It was in London that the world's commercial letter of credit business had centered, due, first, to the presence there of innumerable joint-stock banks, private banks, foreign and colonial bank agencies, merchant banks, and merchants of international repute, who acted as acceptors of the drafts drawn under commercial credit arrangements; and second, to the existence of a broad discount market in which the proceeds of these drafts were made immediately available. It is in London that one would expect to find, therefore, that the melting pot had operated to produce uniformity. But it takes the heat generated by the insistent pressure of necessity to fuse national habits into an international mould. Circumstances had never operated to bring this force into play on London's commercial letter of credit business, and so, even there, the subject is today shrouded in complexities and difficult problems.

The British Practice

The most widely known and respected bankers in the world had offices in London and the ramifications of British trade and shipping had created a demand for sterling bills which made them salable everywhere. The agreement of one of these internationally known bankers to honor drafts drawn upon it when presented at its office in London was sufficient to induce some banker in any trade port, however remote, to negotiate these drafts. It was expected, and rightfully, that local bankers would bid against one another for these bills, in order to obtain the profit on the rate at which the bills would be converted into the local currency, which was sought by the beneficiary who drew them. Consequently, British

bankers' credits were generally alike in taking what is termed the "negotiation" form. That is, they were an undertaking with anyone who might be induced to negotiate the beneficiary's drafts, drawn in accordance with the terms of the credit, that those drafts would be duly honored on presentation at their banking house in London.

If the credit was intended to finance an importation into England for an English customer, the importer, if he were big enough, would approach one of the London accepting bankers directly; if he did not enjoy direct contact with the large accepting banks, he would make his credit arrangement with his local bank, which, in turn, would avail itself of the services of a London acceptance bank.

Circular Negotiation Credit Instrument

It was rather a frequent practice for the opening bank to put the credit in the form of an instrument addressed by it directly to the beneficiary. Figure 7 illustrates this form of credit and indicates how the financing of shipments that did not pass through London was arranged.

This sort of instrument was, at times, mailed by the opening bank directly to the beneficiary. If the opening bank had a branch or correspondent in the domicile of the beneficiary, it was usually mailed to it to be delivered to him. The latter course enabled the local branch or correspondent to vouch for the authenticity of the signatures, and also to bid for the purchase of the drafts. The general custom, however, was not to follow either of these courses, but to deliver the instrument to the accredited buyer, who mailed it to the beneficiary.

CREDITO ITALIANO

London Branch

L/Cr. No. ... *0000/0000* ... 22, Abchurch Lane, E. C. 4,

G.P.O. Box 453

6th April, 1920

Ecuadorian Export Company,

Bahia de Caraquez, Ecuador

Gentlemen:

Please note that a Confirmed Credit has been opened with us in your favor for account of the .... *Italian Import Company,* .... up to .... *£3,000 (Three Thousand Pounds).* ....

Drafts are to be drawn on us at .... *sight* .... against the following documents: Full set of Bills of Lading to the order of shipper, blank indorsed; Policies of Insurance covering ordinary marine and war risk; also invoice relating to.... *One shipment of 50 tons (500 bags) Shelled Corozo Nuts at £60 per ton, shipped from Bahia Mareta (Ecuador) to Genoa by direct steamer during May/June, 1920.* .... Drafts must state that they are drawn under Letter of Credit No. .... *0000/0000* ....

We hereby engage with you as well as with the indorsers and bona fide holders of drafts drawn under this authority that such drafts shall be honored on presentation, provided due compliance has been made with the above conditions.

Very truly yours,

CREDITO ITALIANO,

................, Manager

Figure 7. Circular Negotiation Credit

Cabled Circular Negotiation Credit

All these methods of transmission were inadequate when time was pressing. The time consumed in sending a credit instrument by mail from London to, for example, the Far East, was often too long to enable the instrument to be in the hands of the beneficiary at the time shipment was made and the drafts were drawn. The accredited buyer sometime surmounted this difficulty by delivering the instrument to the beneficiary's agent in London, who cabled its major details to the beneficiary. If the beneficiary was reputable, Far Eastern banks would negotiate his drafts on the strength of such a cable. This practice not only left the door open to fraud, but gave possible occasion for honest controversy when, as sometimes happened, the shortened cable message had omitted some important stipulation contained in the complete instrument.

This latter difficulty could be avoided by having the full details of the credit cabled by the opening bank directly to the beneficiary. Scandinavian banks have attempted recently to adopt this course in opening commercial credits in the United States. Such a cable, sent to an American export company during 1920, read:

> Account Foreign Import Company here, we will honor your three months draft about fifty thousand dollars against invoice ladings marine mine policy six hundred tons bessemer rods at ninety dollars per ton of one thousand sixteen kilos cif Copenhagen discount billstamp for buyers account (stop) Credit irrevocable until February twenty-eighth.

This practice, however, is still open to objections. For one thing, there is no way in which either the beneficiary or the bank to whom he displays the cable for the purpose of persuading it to negotiate his drafts,

can authenticate the message. Neither is there any way in which the negotiating bank can be satisfied that the beneficiary has not already displayed the cable to a competitor and negotiated another draft.

The following is a description of an actual instance of this sort which had serious consequences for the opening bank. The credit had been cabled to the beneficiary by the opening bank, which also mailed an instrument to the beneficiary, containing the usual recital that the amount of drafts negotiated thereunder was to be noted by the negotiating bank on the reverse side of the credit. Upon receipt of the cable the beneficiary negotiated his draft with a local banker. When the instrument arrived he negotiated a similar draft with a second local banker, who noted the amount on the reverse side of the credit. The opening bank honored the first draft on presentation. Although it at first refused to honor the second draft, it was subsequently compelled to do so. The decision was based upon the ground that the first draft had been presented to it so shortly after the mailing of the instrument that it had constructive notice that it could not have been noted on the reverse side of the instrument. The opening bank had, therefore, to bear the loss which otherwise would have fallen upon the bank which had negotiated the second draft in good faith.

Specially Advised Negotiation Credit

Even though the credit is to be opened by mail and there is time for the opening bank to mail its instrument directly to the beneficiary, it is perhaps simpler, if the opening bank has a branch or correspondent in the vicinity of the beneficiary, for the opening bank to instruct that branch or correspondent by letter to notify the beneficiary that the credit has been established. If the credit

is to be opened by cable, the use of this specially advised method has distinct advantages. The branch or correspondent is in possession of a set of agreed test words, by which the identity of the sender and the correctness of the amount of the credit can be verified. One form of cable utilized by a London bank in instructing its United States correspondent in this fashion reads:

> Account Foreign Import Company, advise American Export Company, Providence, Rhode Island, by telegram we open confirmed credit his favor available until first July up to £1,000 against invoices ladings marine war insurance policies sixty casks crystals thirty cents pound cif.

These instructions were intended to authorize the correspondent to do no more than notify the beneficiary of the existence and details of the credit. It is of the type illustrated by Figure 2 (page 32). The advantage to the beneficiary of this method of transmission is that he is assured of the authenticity of the credit. The notifying bank is benefited also by being afforded an opportunity to suggest to the beneficiary that he offer the bills, when drawn, to it for negotiation.

To attain complete safety, it is advisable to carry the specially advised credit a step farther, by requesting the notifying bank also to insert in its letter of advice a requirement that the amount of drafts negotiated be indorsed thereon. A further precaution sometimes employed is to make the credit available only upon presentation and surrender of the stipulated documents at the office of the notifying bank. The beneficiary in this case can, if the credit is in a foreign currency and he is unwilling to accept local funds at the rate of exchange quoted by the notifying bank, request a foreign currency check which he can sell elsewhere. The adoption of

this plan, in addition to preventing double negotiation of drafts, answers the question which might arise in connection with both the Danish and London bank cable instructions just quoted, as to whether the expiration date indicated referred to the date of negotiation in the United States or to that of presentation to the issuing bank overseas.

Australian Credits

It throws a great light on the tenacity of fixed habits, as well as on the adaptability of the commercial credit device, to consider how foreign banks met the situation created during the war by the forced transference of a large volume of the purchases of their merchants from London to New York. The Australian banks, for instance, clung, where they could, to the sterling circular negotiation credit providing for the acceptance of the beneficiary's drafts in London, which they had formerly utilized in buying from England. An example of this type, the "Eastern or American credit" employed by an Australian bank, is found in Figure 8. It is the classic circular negotiation type, illustrated by Figure 1 (page 31).

Some Australian banks assisted the beneficiary in finding an American bank which was sufficiently acquainted with their credit standing to negotiate the drafts readily, by listing at the bottom of the instrument their correspondents in the United States and terming them the banks' agents for the purposes of the credit. These correspondents, in case they negotiated drafts, scarcely stood in any better position than any other bank which might voluntarily negotiate them. Their relationship to the credit is illustrated by Figure 3 (page 33).

Where the American beneficiary insisted upon a dollar

EASTERN OR AMERICAN CREDIT

Letter of Credit No. .... *0000* .... £ .... *3,500* ... Stg.

THE COMMERCIAL BANK OF AUSTRALIA, LIMITED

337–339 COLLINS ST., MELBOURNE

Victoria, Australia, ... *16th March, 1918* ....

.... *The American Export Company* .... of .... *New York,* .... being desirous of drawing upon The Commercial Bank of Australia, Limited, Bishopsgate, corner of Leadenhall St., London, at ...... *sight* .... at any time within .... *six* .... months from this date for full invoice value of .... *steel strip* .... to be shipped to .... *Melbourne and / or Sydney* .... on account of .... *Australian Import Company of Melbourne, Victoria,* .... for any sum not exceeding in the whole the sum of .... *Three Thousand Five Hundred Pounds Stg.* ....

Now The Commercial Bank of Australia, Limited, doth hereby engage with the Drawers, Endorsers, and bona fide holders of Bills drawn under this Credit that the Bank will on production to them of a Certificate by one of the Agents mentioned in the attached list that the conditions of this credit have been complied with and that the said Agent has received from the Drawer the Invoices and Bills of Lading to order and blank endorsed of said Goods so shipped and Policies of Insurance, including war risk, thereon to a sufficient amount (covering particular average if required) specifying the same and that the said Bills are drawn on account of the said .... *Australian Import Company* .... of .... *Melbourne* .... under this Letter of Credit, accept such Bills on presentation thereof at the Office of the Bank in London and honor the same at maturity.

The Shipping Documents are to be forwarded to this Bank at Melbourne and purchasers of Bills under this Credit are to note the amount of said Bills on the back hereof and see that they are marked "Drawn under Melbourne Credit No. .... *0000* .... of .... *16th March, 1918.*"

................, Manager

................, Accountant

Figure 8. Australian Eastern or American Sterling Credit

credit, the Australian practice was to utilize the services of an American correspondent as its notifying and paying agent. A specimen of such a credit is found in Figure 9. This credit leaves it to conjecture whether or not it is to be regarded as being irrevocably valid until the expiration date indicated.

Canadian Credits

The situation of the Canadian merchants and banks was similar to that of the Australian. The specimen of a Canadian bank United States dollar credit given in Figure 10 shows, however, a somewhat different way of meeting it.

Instead of using the New York accepting bank as the notifying agent, as the Australian bank had done in its dollar credit, the Canadian bank issued its own instrument in duplicate. The original was mailed to the beneficiary in Spain to enable him to negotiate his drafts with a local Spanish bank on the strength of the Canadian bank's agreement that the drafts would be honored on presentation at the New York bank; and the duplicate went to the New York bank to serve as its authority to accept and pay the drafts upon presentation.

The standing of the Canadian bank was quite sufficient to make the credit effective without any bolstering of the arrangement by the confirmation of the New York bank, which came into the transaction simply because the beneficiary wanted to draw drafts in United States dollars, both because United States dollars were more readily salable in Spain than were Canadian dollars, and because the existence in New York of a broad discount market for bank acceptances made its proceeds immediately available to the negotiating banker, after acceptance by the New York bank.

Credit No. .... *oooo* .... $ .... *14,000*. ....

THE COMMERCIAL BANK OF AUSTRALIA, LIMITED

Melbourne, ... *March 16, 1918* ....

To *The National City Bank of New York,*

New York City

You are hereby authorized to pay and charge to our account with yourselves if presented within .... *six months* .... of this date the drafts at sight of .... *The American Export Company* .... of .... *New York* .... upon .... *The Australian Import Company* .... of .... *Melbourne* .... to the extent in the aggregate of .... *Fourteen Thousand Dollars, United States currency*. ....

Such drafts to show on the face that they are drawn under Melbourne Credit No. .... *oooo* .... of .... *March 16, 1918*, ... and to be accompanied by Invoices, Bills of Lading, and Policies of Insurance, including war risk, of .... *steel strip* .... shipped to .... *Melbourne and/or Sydney* .... on account of .... *The Australian Import Company* .... consigned to The Commercial Bank of Australia, Limited, or to shipper's order and endorsed in blank.

The shipping documents are to be forwarded to this Bank at .... *Melbourne* .... and the amount of relative drafts noted on the back hereof.

................, Manager

................, Accountant

Figure 9. American Dollar Credit Opened by an Australian Bank

THE DOMINION BANK

No. . . .*0000*. . .

Toronto,. . . . *July 5, 1919* . . . .
(Canada)

To *The National City Bank of New York,*
New York City

We hereby authorize . . . . *The Spanish Export Company* . . . . of . . . . *Malaga, Spain,* . . . . to value on you at . . . . *ninety days' date* . . . . for account of . . . . *The Canadian Import Company* . . . . of . . . . *Toronto* . . . . for any sum or sums not exceeding in all . . . . *One Thousand Dollars* . . . . to be used as they may direct for the payment of the Invoice value of . . . . *Raisins* . . . . to be purchased for account of . . . . *The Canadian Import Company* . . . . and to be shipped to Canada or any Atlantic Port in North America.

The shipments must be completed and the drafts drawn before the first day of . . . . *November* . . . . next and advice thereof given to you in original and duplicate, such advice to be accompanied by Bill of Lading filled up to the order of The Dominion Bank with either an abstract of invoice endorsed thereon or a copy of invoice attached for the property shipped as above.

All the Bills of Lading issued are to be forwarded direct to you except the one sent to us by the vessel carrying the cargo and the one retained by the Captain of said vessel.

The original Invoice, properly certified, is to be forwarded to The Dominion Bank.

Insurance . . . . *Marine and War Risk* . . . . to be effected here.

Each draft drawn under this Credit must bear upon its face the words "Drawn against The Dominion Bank, Toronto Branch, Credit No. . . . . *0000,* . . . . dated . . . . *July 5, 1919.*"

We hereby agree with the drawers, endorsers, and bona fide holders of Drafts drawn under and in compliance with the terms of this Credit that the same shall be duly honored on presentation at your office in New York.

For THE DOMINION BANK,

. . . . , Manager

. . . . *$1,000.00* . . . . , Accountant

Figure 10. American Dollar Credit Opened by a Canadian Bank

Credits from Continental Europe

The continental banks, like those of the United States, had apparently leaned heavily on the services of their London offices and correspondents as notifying, confirming, and accepting agents, for when they turned from London to New York they chose to issue their credits for American merchants through the medium of New York banks, to whom they cabled or wrote their instructions. The specimen shown in Figure 11 is typical.

Far Eastern Credits

To understand the credits which came to our merchants from the Far East, it is necessary to begin with the authority to purchase, which had developed there. A typical authority to purchase reads as shown in Figure 12.

While it is usually stated by bankers and writers that the authority to purchase must not be regarded as a banker's credit, it would appear to fall within the classification of a revocable banker's credit, by which the buyer's bank authorizes the purchase of a draft, but a credit of which the bank which is authorized to make the purchase, and not the shipper, is the beneficiary. As a matter of actual practice, drafts drawn under authorities to purchase are usually negotiated by the notifying bank for the account of the buyer's bank by debiting the face amount of the draft, plus the commission, to the account of the buyer's bank. The notifying bank, therefore, occupies a neutral position before drafts are paid and drops from the transaction upon payment. The vital distinction between the Far Eastern authority to purchase and any other credit which is revocable without notice to the beneficiary is that the seller does not drop out, upon being paid, but continues a party until the

DEN DANSKE LANDMANDSBANK
HYPOTHEK– OG VEKSELBANK
AKTIESELSKAB

Copenhagen K., ... *February 1, 1920* ....

Credit No. .... *0000* ....

To *The National City Bank of New York,*
New York City

Dear Sirs:

We herewith beg to open with you the following .... *confirmed* .... credit in favor of .... *The American Export Company*..
for account of .... *The Danish Import Company, Copenhagen* .... for an amount of .... *about* ....
.... *$55,000.00* ....
available by .... *three months' draft* ....
against delivery of the following documents:

Bill of Lading, issued "to order" and duly endorsed or issued to .... *buyers*. ....

Policy of Insurance .... *covering Marine and War Risk* ....

Invoice ....
.... *of 600 tons Bessemer rods at $92 per ton of 1,016 kilos, c.i.f. Middelfort*. .... Discount and Bill Stamp for buyers account..
shipped per .... from ....
to..

Kindly forward documents to us. This credit is irrevocable until .... *February 28, 1920*, ... on the above conditions.

Yours respectfully,

DEN DANSKE LANDMANDSBANK,
Hypothek- og Vekselbank
Aktieselskab

Figure 11. Instructions Sent to New York Bank by European Bank Opening a Dollar Credit

INTERNATIONAL BANKING CORPORATION

60 WALL STREET, NEW YORK

October 3, 1921

American Export Company,
New York City

Dear Sirs:

We beg to inform you that we have been authorized by the Manager of our Branch at .... *Shanghai* .... to negotiate your bills on .... *The Chinese Import Company* .... to the extent of........ *$1,000 (One Thousand Dollars)*...... for 100% invoice cost of .... *cotton sheetings* .... shipped to............ *Shanghai* ....

The bills are to be drawn at .... *ninety days'* .... sight and must be accompanied by FULL SET OF BILLS OF LADING; INVOICES and MARINE INSURANCE POLICIES, ALL IN DUPLICATE.

Shipping documents must be made out to "ORDER" and blank endorsed.

The above documents must be duly hypothecated to the Bank against payment of the bills.

Please note that this advice is NOT to be considered as being a "BANK CREDIT" and does not relieve you from the ordinary liability attaching to the "DRAWER" of a Bill of Exchange.

All drafts under this Authority to Purchase to be marked "DRAWN UNDER .... *Shanghai* .... A.P.No. .... *0000* ...."

Kindly hand in this letter with your drafts in order that the amount of same may be endorsed on the back hereof.

This Authority expires on .... *January 1, 1922*, ... but is subject to cancellation by our giving you notice to such effect.

Yours faithfully,

....

Figure 12. Typical Authority to Purchase

ultimate liquidation of the draft by the buyer, by reason of the fact that recourse is retained against the seller as drawer of the draft on the buyer.

The authority to purchase, it will be observed, clearly states this fact. The issuance of the authority merely means that the buyer's bank considers that all bills drawn will be duly cared for and that it will do all in its power to protect the interests of the shipper. It indicates that the buyer expressly gives the shipper authority to draw and requests his bank to buy the bills which the buyer agrees to accept. It is to be taken as meaning that in the opinion of the buyer's bank the buyer will carry out the terms of the letter of guaranty he has lodged with it, a specimen of which is shown in Figure 13.

The general use of the authority to purchase in the Far East had familiarized Japanese and Philippine Island bankers and merchants with a credit document which provided that the beneficiary's drafts were to be drawn on the buyer rather than on the issuing or paying bank, as was the case elsewhere. They had also become familiar with the usual form of circular negotiation credit of English pattern by negotiating their merchants' drafts drawn thereunder. By incorporating the idea of a draft on the buyer, derived from the authority to purchase, in the circular negotiation form, they achieved a truly puzzling credit, as we shall later see, so far as the question of recourse on the beneficiary as drawer of these drafts is concerned. These credits were mailed by the issuing Far Eastern banks directly to the American beneficiaries. They were not actually negotiation credits, however, even though they merely guaranteed due acceptance and payment at maturity by the drawee of drafts drawn in compliance with their terms, for the American bank which was designated as the negotiating agent was author-

AUTHORITY TO DRAW
(LETTER OF GUARANTY)

A. P. No. .... *0000* ....
Cabled .... *10-1-21* ....
October 1, 1921

International Banking Corporation.
Shanghai, China

Dear Sir:

We beg to inform you that we have authorized .... *The American Export Company, New York,* .... to draw on us with recourse to the extent of .... *$1,000 at ninety days' sight* .... for 100% invoice cost against the following documents:

Bill of Lading	Invoice
Insurance Certificate	Consular Invoice

to cover shipment of .... *cotton sheeting* .... from .... *New York* .... to .... *Shanghai.* ....

Bill of Lading to order of International Banking Corporation. Freight to be prepaid; Marine Insurance covered by shipper.

We agree:

1. To accept upon presentation all bills drawn pursuant hereto.
2. To hold the International Banking Corporation harmless because of any damage to merchandise shipped or deficiency or defect therein or in the documents above described.
3. That the said documents, or the merchandise covered thereby, and insurance shall be held as collateral security for due acceptance and payment of any drafts drawn hereunder, with power to the pledgee to sell in case of non-acceptance or non-payment of the draft to them attached, without notice at public or private sale and after deducting all expenses including commissions connected therewith, the net proceeds to be applied toward payment of said drafts. The receipt by you of other collateral, merchandise or cash, now in your hands, or hereafter deposited, shall not alter your power to sell the merchandise pledged and the proceeds may be applied on any indebtedness by us to the Bank due or to become due.
4. To pay your commission of....*1/8%*....for negotiating of drafts hereunder.

This engagement to commence from date hereof and to apply to all Bills drawn within .... *three* ....months.

Please advise by .... *cable.* ....

Yours faithfully,

CHINESE IMPORT COMPANY

The above is our A. P. No. *0000* Please do the needful.

Figure 13. Buyer's Letter of Guaranty Issued in Connection With an Authority to Purchase

ized to pay the beneficiary the full amount of his draft, without discount, and immediately charge that payment, plus its commission, against the dollar account maintained by the Far Eastern bank with the American bank. Such a credit is shown in Figure 14.

At first glance this credit would appear to fall under the typical circular negotiation form, which is exemplified by the Credito Italiano credit (Figure 7, page 50), and illustrated by Figures 1 (page 31), and 3 (page 33). It is, however, converted to the straight form, and though not specially advised, is rendered available only at one bank, by the inclusion of the provision for negotiations without discount by the New York correspondent. It is therefore illustrated by Figure 2 (page 32).

The Far Eastern banks, as a general thing, requested the American bank which was to act as paying agent, to confirm to the beneficiary by a separate advice, its agreement to pay the drafts when presented. The credit then falls under Figure 4 (page 35).

Our Dollar Import Credits

When the acceptance privilege was accorded to our national banks in 1914, it was not thought that there would be much change in the firmly entrenched habit of our foreign sellers in demanding sterling credits, and of our merchants in furnishing them. This prediction took no account of the effect of the war on the exchanges. Before we had come to realize it, while sterling and the other continental currencies began, in irregular fashion, that downward plunge which was to carry them to hitherto undreamed of depths, the dollar became the most wanted and the most stable medium of exchange. In a brief period London was supplanted. Ninety-five per cent of our import credits were dollar credits. By issuing their

THE DAI-ICHI GINKO, LIMITED

COMMERCIAL LETTER OF CREDIT

L. P. No. .... *000* .... Tokyo, ... *August 9, 1920* ....

To *American Export Company,*
New York City

Dear Sirs:

We hereby authorize you to draw draft or drafts as follows: Upon .... *Japanese Import Company, Tokyo,* .... at a usance of .... *ninety days* .... after sight, to the extent of .... *Three Hundred Forty Dollars only ($340.00),* .... for full invoice cost of .... *$340.00;* .... shipment of .... *glassware* .... from .... *New York* .... to .... *Tokyo,* .... not later than .... *October 5, 1920.*

Each draft must be accompanied by an Invoice in duplicate and the full set of Bills of Lading made out to order and blank endorsed.

Insurance Policy to accompany the draft.

All drafts against this Credit must bear the clause "Drawn under Letter of Credit L. P. No. .... *000,* .... dated .... *Tokyo, August 9, 1920,"* .... and the amounts of such draft or drafts negotiated must be written off on the back hereof and this Letter is to be returned to us when exhausted or expired.

We hereby guarantee that all drafts drawn in compliance with the terms and conditions of this Credit shall be duly accepted and paid at maturity by the drawee.

We are,

Yours faithfully,

For THE DAI-ICHI GINKO, LIMITED

....

Drafts against this Credit will be negotiated by the National City Bank of New York, in New York City, without discount.

Figure 14. Guaranteed Authority to Purchase

own instruments and accepting their own drafts our banks saved their customers the commission that had previously been paid to London bankers for this service. There was an additional advantage to the American importer. As his obligation was now to settle in dollars, he no longer needed to watch the sterling exchange rate. The aggressiveness of the larger banks in establishing branches and agencies abroad and in soliciting correspondent relationships with foreign banks soon brought them into the circle of international bankers whose obligation would be freely purchased everywhere. There was no departure, therefore, in the form of the import credit, except that it was issued from the United States and made payable in dollars. A typical credit of this character, the relationship of the parties to which is shown in Figure 1, is illustrated by Figure 15.

Our Dollar Export Credits

The great new task to which the world's bankers were put was that of establishing dollar credits in New York to pay for the flood of goods that was pouring out of our borders. Foreign banks bought dollars and opened accounts in New York banks. The classic negotiation form of credit would not do for the task that was now to be performed. The obligation of the credit must be, not to honor sterling drafts in London or franc drafts in Paris, but dollar drafts in New York. The obligations consequently took the form of an undertaking that drafts would be honored upon presentation to the office of a New York correspondent. It was possible, theoretically, to use the circular form. The foreign bank could mail its instrument to the beneficiary in the United States and the instrument could contain the familiar undertaking that the New York correspondent would pay drafts

THE NATIONAL CITY BANK OF NEW YORK

Letter of Credit No. .... *00000* ....

New York, ... *Dec. 31, 1921* ....

Argentine Export Company,
Buenos Aires,
Argentine

Dear Sirs:

At the request and for the account of .... *American Import Company* ....*of New York* .... we hereby authorize you to value on

The National City Bank of New York, New York ....

at......... *ninety days sight* ....for any sum or sums not exceeding a total of........ *One Thousand Dollars*............ accompanied by commercial invoice, consular invoice, bills of lading...

....

representing .... shipment of ...... *wool* ....

....

....

insurance ...... *effected here* ....

Bills of lading for such shipment must be drawn to the order of .... *shipper, blank endorsed.* ......

....

A copy of the invoice, consular invoice, and one bill of lading must be sent by the bank negotiating drafts, direct to .... *The National City Bank of New York* .... attaching to the draft a statement to that effect.

The amount of each draft negotiated must be endorsed hereon.

We hereby agree with bona fide holders that all drafts drawn by virtue of this credit, and in accordance with the above stipulated terms, shall meet with due honor upon presentation at ....

If drawn and negotiated on or before .... *April 1, 1922.* ....

Respectfully yours,

THE NATIONAL CITY BANK OF NEW YORK

N. B. Drafts drawn under this credit must bear the clause "Drawn under Letter of Credit No. .... *00000* ....
Dated .... *Dec. 31, 1921* ...."

Figure 15. Dollar Import Credit

drawn in accordance with its terms. A copy of this credit could be sent to the New York bank and constitute its authority to honor the drafts when presented. But it was simpler, as has already been indicated, for a foreign bank to inform its New York correspondent by mail or cable of the opening of the credit and request it to advise its terms to the beneficiary.

The Credit Advice

A letter written by the New York bank to the beneficiary would suffice for an advice. As the volume of this business developed, however, the American penchant for standardization came into play. Forms were drawn, to be filled in and serve as advices. To judge from the forms produced, they were devised by collecting from any convenient source as many types of credit instruments as could be found and borrowing the most elegant phrase from each one. Most banks equipped themselves with two forms—one labeled a confirmed credit and the other an unconfirmed credit. They were all after the general pattern of those illustrated in Figures 16 and 17.

With such forms on hand, it was the general practice to insert the details of the credit from the instructions which were received, without much attempt to analyze the precise nature of the instructions other than to ascertain whether the credit was to be confirmed or unconfirmed.

If commercial credit practices elsewhere had been uniform, this plan would have simplified the operation. When applied to the differing practices of our new customers, the variety of which has been here but sketchily outlined, this plan, it is now evident, of attempting to pour myriad instructions into a common mould, had about the same prospect of success as that of running

THE NATIONAL CITY BANK

OF NEW YORK

New York, ... *December 31, 1921* ....

American Export Company,
New York City

When referring to this credit, please mention our No.... *00000* ....

Dear Sirs:

We have been requested to open a credit in your favor under the terms and conditions stipulated below:

Opened by .... *Buenos Aires Branch* ....

Account .... *Argentine Importing Company* ....

Amount .... *$1,000.—* ....

Available by draft .... *at sight on us* ....

Covering .... *cotton goods* ....

Drafts drawn under this credit must be presented not later than .... *April 1, 1922.* ....

Documents required .... *Full set ocean bills of lading to order, blank endorsed.* ....
Marine Insurance Certificate.......

Payment will be facilitated if this advice accompanies your documents when presented at our Commercial Credit Department. If transfer is requested this advice must be surrendered for cancellation.

This is not to be regarded as a confirmed credit, or an agreement on our part, and is therefore subject to modification or revocation at any time.

Please note that we can accept only Bills of Lading issued by the transportation company carrying the goods.

Instructions will be interpreted in accordance with the regulations shown on the reverse side.

Respectfully yours,

THE NATIONAL CITY BANK OF NEW YORK

If impossible to comply with the conditions stated above, communicate with us before making shipment. The conditions embodied in this credit must be adhered to, otherwise payment will not be effected.

Figure 16. Confirmed Dollar Export Credit

THE NATIONAL CITY BANK

OF NEW YORK

New York .... *December 31, 1921* ....

American Export Company,
New York City

When referring to this credit, please mention our No. .... *00000* ....

Dear Sirs:

We are pleased to inform you that we have been requested to open a credit in your favor under the terms and conditions stipulated below

Opened by .... *Buenos Aires Branch* ....

Account .... *Argentine Importing Company* ....

Amount .... *$1,000.—* ....

Available by draft .... *at sight on us* ....

Covering .... *cotton goods* ....

Drafts drawn under this credit must be presented not later than .... *April 1, 1922*. ....

Documents required .... *Full set ocean bills of lading to order, blank endorsed.* ....
Marine Insurance Certificate. ......

This is to be regarded as a confirmed credit. If impossible to comply with the conditions stated above, communicate with us before making shipment. The conditions embodied in this credit must be adhered to, otherwise payment will not be effected. Please note that we can accept only Bills of Lading issued by the transportation company carrying the goods.

Payment will be facilitated if this advice accompanies your documents when presented at our Commercial Credit Department. If transfer is requested this advice must be surrendered for cancellation.

Respectfully yours,

THE NATIONAL CITY BANK OF NEW YORK

Figure 17. Unconfirmed Dollar Export Credit

automobile parts made in French, British, Italian, and Belgian factories through the Ford assembly plant. The prerequisite of success in providing a standardized product is a standardized supply. The weakness of the American plan of operation was that the banks were not transmitting to the beneficiary in many cases exactly the sort of credit they were requested by their principals to advise.

CHAPTER V

THE CONFUSION CONCERNING CONFIRMATION

The Issue

In the analysis of the commercial credit practices of other countries, which have had our consideration in the preceding chapter, we found in the various methods employed no irreconcilable differences in principle. We have seen that most of the confusion which has resulted from the haphazard development of commercial credit practice is of the sort which is the usual concomitant of lack of standardization. That is to say, while each community might profitably abandon some feature of its practice for a better one adopted by its neighbor, there is no fundamental vice in the commercial credit habits of any of the communities. The universal adoption of clearly defined practice, no matter whose, would automatically end the confusion.

The situation is, to continue the analogy borrowed from the automotive industry, similar to that in which our government found the automobile truck business at the time of our entry into the war. There were many truck manufacturers in this country, the product of any one of which would have been suitable for the government's needs with little or no refinements beyond those called for by the peculiar necessities of war service. It was not any fundamental difference between makes which led the government to seek standardization, but the economy resulting from carrying supply parts for one

design, and training men to master, not a score, but one mechanism. In the main, the process of standardizing commercial credit practice is likewise simply one of refinement.

The search after definitions and the effort at fundamental analysis of commercial credit instruments and functions has, however, brought to light an appparently irreconcilable difference of opinion between English and American bankers concerning a basic principle. The issue is as to what constitutes a confirmed bankers' credit.

The English View

The English conception of a confirmed bankers' credit is set forth by William F. Spalding, an English writer and lecturer on foreign exchange, in his recent book, "Bankers' Credits" (London, 1921). The British viewpoint can best be stated by briefly summarizing Mr. Spalding's definitions of terms in his own language. He says that a credit "under which the importer himself accepts and pays the bills, even though it be advised through the intermediary of a banker, is, strictly speaking, the common credit." A credit under which the banker "himself guarantees to accept or pay bills is the bankers' credit" (page 41). "A confirmed bankers' credit is one issued by a bank in which that bank undertakes, subject to the fulfillment of certain terms and conditions, to accept and pay at maturity the bills drawn under the authority so given. It is the banker here who gives the actual authority, not the importer" (page 54). He says it is agreed that a confirmed bankers' credit cannot be revoked, but that about the right to cancel a bankers' credit there is a difference of opinion. There is also, he goes on to say, a variation of the bankers' credit, taking

"the form of an intimation from one bank to another that a merchant or bank has opened a credit with them for bills to be drawn under terms, and this intimation is sometimes accompanied by the statement that the credit is an 'unconfirmed credit,' that is, it is merely an advice; consequently the right of cancellation is reserved. However, even in an unconfirmed credit, the exporter does not draw his bills on the importer, but on a bank, although the bank does not guarantee or confirm in advance that it will give its acceptance to the bills." He adds: "Needless to say, there is considerable controversy about the precise reliance to be placed on an unconfirmed credit, and bankers hold that the value of such a credit is that it is valid until cancelled; but the bank has the right to cancel it whether the beneficiary agrees or not" (page 45). There is, he further observes, a dispute as to whether notice of cancellation must reach the advising bank prior to negotiation of drafts to become effective, or whether the "intimating" bank can give effective notice of cancellation upon presentation to it, in London, of negotiated drafts (page 46).

The American View of the Credits

The American view is that an arrangement under which the importer himself accepts and pays the drafts, but which is advised through the intermediary of a banker, is, if the banker authorizes the purchase of the drafts, an authority to purchase. A credit under which the banker himself guarantees to accept or pay bills is a bankers' credit. A credit advised by a notifying bank under instructions from the opening bank, in which the notifying bank confirms the undertaking of the opening bank to accept and pay at maturity the bills drawn under the authority so given, is a confirmed bankers' credit.

It is agreed among American bankers that neither an irrevocable bankers' credit nor a confirmed bankers' credit can be revoked without the consent of the beneficiary. An unconfirmed credit, in the American view, is a credit advised by a notifying bank to the beneficiary, without obligation on the part of the notifying bank. To the English variation of "unconfirmed" bankers' credit, taking "the form of an intimation from one bank to another that a merchant or bank has opened a credit with them for bills to be drawn under terms," with its interesting doubts as to whether it can be canceled, and if so, where and how, the American banker has given the reception it deserves, by ignoring it.

The English Statement of the American View

Mr. Spalding says (page 62), "The American view is that a confirmed credit, also called an irrevocable credit, is one that cannot be canceled without consent of the buyer and seller; and when the American bank has notified the seller that such a credit is established in his favor, it is held responsible for payment if the terms of the credit are properly carried out." If Mr. Spalding is referring to a credit in which the American bank is not the opening bank but the confirming bank, the statement is correct, except for the implication that the terms "confirmed" and "irrevocable" are used synonymously in this country. In the American view, a confirmed credit must of necessity be irrevocable on the part of the opening bank, in order to make the confirmation by the notifying bank the effective protection the beneficiary seeks. But the terms are in no sense used synonymously. Not only does the American view recognize the existence of, but, as we shall later see, American bankers provide, a form of credit which is irrevocable but unconfirmed.

Is "Confirmed" Synonymous with "Advised"?

The word "confirm" is derived from the Latin, *con* plus *firmare,* to make firm. Its dictionary definition is "to make firm or firmer; to add strength to; to corroborate." Confirmation is defined as "a strengthening, ratifying or sanctioning; that which gives new strength to." It therefore connotes an addition to something already in existence—additional security given to an obligation already in force. The British usage seems to be an attempt to give the word "confirm" three distinct meanings, only one of which is justified by its derivation or normal use.

First, it is used by some British bankers—so Mr. Spalding says, and he admits that it indicates a "confusion in ideas"—as a synonym for "advise." Yet he lapses into the same error when he refers to a "mere confirmation or advising" of a credit through one or more banks or bank offices (page 56). He quite properly continues that the mere passage from one bank to another of authority to negotiate bills "does not make the credit a confirmed bankers' credit, otherwise it would be possible to apply the term to practically every form of credit which is issued and advised through the intermediary of a bank." If he clung fast to this idea he would be on safe ground. Yet he writes also of "an 'unconfirmed credit,' that is, merely an advice," or "intimation from one bank to another" (page 45). He carries the word "advised" to the other extreme, and displays some doubt as to whether an unconfirmed credit is, even between bank and bank, an authority to negotiate bills.

How much simpler, and how much more correct, to recognize the fact that "advised" is not synonymous with either "confirmed" or "unconfirmed"! To advise is to notify, and the notification can be of either an

unconfirmed or a confirmed credit, as we shall later see.

Is "Confirmed" Synonymous with "Irrevocable"?

According to Mr. Spalding, the addition of the word "confirmed" to "bankers' credit" creates a "confirmed bankers' credit," in which the issuing bank undertakes to accept and pay at maturity the bills drawn under the authority so given. "There is no uncertainty," he continues, "about the confirmed bankers' credit, which it is held, once issued to the grantee, cannot be revoked by the banker" (page 54). Here he uses the word "confirm" in a second and an entirely new sense. A "confirmed" credit is an "irrevocable" credit.

As Mr. Spalding "remembers hearing confirmed bankers' credits defined" in a manner contrary to his first use of the word, "by a banker in one of the Law Courts," there is reason to believe that "confirm" and "advise" are not generally given a synonymous use, even in England. There is no doubt, however, that "confirmed" and "irrevocable" are there regarded as interchangeable terms. One of the London banks, for instance, gave its New York correspondent the following instructions:

We request you to establish a Credit with your goodselves to the extent of £2,000.—(two thousand pounds sterling), authorizing the negotiation of the draft or drafts, without recourse on drawers of ...., (address)................, drawn on this bank at sight, payable in London.

The drafts are to be secured by the due endorsement and delivery as Collateral Security of full set of clean blank endorsed bills of lading for 3000 dozen hose and half hose.

The insurance, marine and war, with 15 per cent. added, is to be effected by shippers and the policy must be attached to the drafts.

Kindly note that this credit is opened on behalf of our clients,

................, ..., and unless previously cancelled it is to be available until 23rd of July, 1920.

Drafts drawn under this credit to contain the clause "Drawn under credit No. 3164 of Barclays Bank, Ltd., dated London 30th January, 1920."

We undertake that all drafts negotiated under the terms of this credit will meet with due honor on presentation, provided they are marked as being so drawn.

Answering a query as to what steps must be taken to render the cancellation effective, this bank explains to its American correspondent, which had advised the beneficiary of the existence of the credit without obligation on its part, as follows:

Such cancellation would become operative as soon as instructions are received by you from us to this effect, provided no drafts had been negotiated by you, and there is no obligation to obtain the beneficiaries' agreement. The advice which you have issued to the beneficiaries is therefore quite in accordance with our instructions.

The last paragraph of our letter is, of course, an undertaking to your goodselves that all drafts negotiated in accordance with the terms of the credit will be duly honored by us on presentation, but this undertaking does not convey any guarantee on our part to the beneficiary, and merely covers any drafts actually negotiated prior to the receipt by you of any instructions to cancel the credit.

The British bank terms this an "unconfirmed" credit. Suppose the British bank were to eliminate the right to revoke during the stipulated life of this credit. It would thus convert it into an irrevocable credit; but the British bank would term it a "confirmed" credit. Yet no lawyer could then read into it any more guaranty on the part of the British bank to the beneficiary than previously. A resort to the graphic method of illustration may empha-

size this fact. This British credit, in the unconfirmed form, represents a liability to the correspondent in connection with any draft negotiated prior to receipt by the correspondent of notice of cancellation, but no liability of any character to the beneficiary. This state of affairs is like that which exists in the case of a reimbursement credit, illustrated by Figure 5 (page 42).

To convert it into what the British bank terms a "confirmed" credit, the British bank would waive the right to revoke. This action on its part would, however, simply terminate its right to extinguish its existing liability, and would not add or subtract anything from the liability. The graph would remain unchanged. The way for the British bank to engage itself to the beneficiary would be to include him in its undertaking, but that could have no further effect than to entitle him to notice of cancellation, if the stipulation for cancellation remained. By including the beneficiary in its undertaking to honor drafts negotiated prior to receipt of notice of cancellation, the credit would, until revoked, fall within the negotiation form illustrated by Figure 3 (page 33).

If, on the other hand, the British bank made the credit irrevocable, and asked its American correspondent to state to the beneficiary that it also undertook that drafts negotiated within its stipulated life would be honored on presentation in London, it would be converted into a confirmed credit in the American sense. Such a credit has already been illustrated by Figure 4 (page 35).

If we confine the term "irrevocable" to a credit in which the right of cancellation is waived, and the term "confirmed" to a credit in which one bank adds its obligation to that of another, the language used will illuminate, instead of obscure, the difference between two allied but separate principles.

The Right Use of the Word

The odd part of the matter is that the English banker also uses the term "confirmed" in this third sense, to apply to a credit opened by a London bank with a joint undertaking by the London and New York banks that the drafts will be honored on presentation at the New York bank. For example, a London bank in instructing its New York correspondent to advise an American beneficiary that it has itself opened a confirmed credit in his favor, adds that it does or does not wish the New York correspondent to confirm it for the London bank's account. It is only in this latter sense that the British bank uses the term in the fashion which is justified by its dictionary definition; and it is only in this latter sense that the term is employed by American bankers.

The American use of the word "confirm," and also the English usage last noted, give it the natural meaning to which it is entitled as a verb in good standing in the English language, i.e., as meaning to strengthen, ratify, or sanction. When an American bank confirms a credit it does what the word implies—adds its obligation to the obligation of a foreign bank, for the further protection and assurance of the beneficiary. That is what the American merchant expects the American bank to do. An American beneficiary in asking for a confirmed credit is seeking the obligation of an American bank near at hand, in addition to that of an overseas bank.

How the Credit Obligation Arises

Before we can attempt to pass judgment on these views, we must come to an understanding of the way in which the obligation to pay drafts, which is at the basis of commercial credits, arises. It was a principle of English commercial law established by Lord Mansfield

that a written promise to accept a future bill, or one not in existence, was binding if the bill were taken by the holder upon the faith and credit of such promise.[1] This principle has been given effect in the Uniform Negotiable Instruments Law, which is in effect in most of the states and territories of the United States. Section 223 of the New York Act reads:

> An unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value.

In the typical negotiation credit we find this phrase: "We hereby agree with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same shall be duly honored on presentation." This is apparently "an unconditional promise in writing to accept" of the sort contemplated by the act. In this event, though a draft be refused acceptance, a bona fide holder could sue the drawee as on an accepted draft, utilizing the credit instrument as evidence of the undertaking to accept.

This theory, however, appears to provide no satisfactory basis on which to argue for the irrevocability of the credit, in advance of the negotiation of the drafts in question on the faith of the agreement to accept. A more satisfactory theory, and the one which appears to be worthy of and gaining the most support of all the theories which have been advanced as to the contract rights created by a letter of credit, is the doctrine that it constitutes a mere contractual obligation from the opening bank to the beneficiary, supported by a consideration in the form of the commission paid to the opening bank by the purchaser of the goods. (See Chapter XVII.)

[1] See Bank of Michigan v. Ely, 17 Wendell (N. Y.) 508.

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The Obligor of a Circular Credit

The value of any commercial letter of credit to the beneficiary results, therefore, from whatever contractual undertaking is made with him by some party to it. Take the case of the stereotyped form of circular negotiation credit, for example. If the instrument is issued by the opening bank directly to the beneficiary, obviously only the bank issuing the instrument is bound.

Let us now consider the case in which a foreign bank sends its credit instrument to the beneficiary, in terms by which it undertakes that its New York correspondent will honor drafts drawn in accordance with its terms. The Dominion Bank of Canada credit, shown in Figure 10 (page 58), is an excellent illustration of this type. Can such a credit, even if it is irrevocable, be held to be the legal obligation of the New York correspondent? Obviously it cannot be, unless the New York bank separately undertakes, in writing, to honor the beneficiary's draft.

However such a credit may be regarded in England (Mr. Spalding is silent on this point, which is the crux of the whole discussion about the meaning of "confirmation"), our merchants do not regard a credit as confirmed, even though it be the irrevocable obligation of the issuing bank, unless the American bank which is to honor the drafts confirms that it will honor them.

No Basic Difference in English and American Practices

The present confusing use of the term "confirmed" by the British undoubtedly results from the historical development of the business. In the days when by reason of the popularity of sterling and their own world-wide reputation, the London banks were called upon to accept drafts drawn against commercial credits originating with

banks, both English and foreign, of only local reputation, the beneficiary and the negotiating bank were not interested in having any obligation but that of the London banker. It was the undertaking by the London bank, which was really a secondary obligation, that actually operated to induce negotiation. It would have been idle for local banks to have adopted the course which Australian and Canadian banks can now employ, as evidenced by Figure 8 (page 55) and Figure 10 (page 58), of mailing the credit to the beneficiary and assuring him that the correspondent on whom the drafts were to be drawn would honor them. It would not have made their own credit any more effective to have mailed it to the beneficiary, as the Japanese banks do, as evidenced by Figure 14 (page 65), to have requested the bank upon which the drafts were to be drawn to confirm by a separate advice that they would be accepted on presentation. It was the confirmation of the arrangement by the banker who was to accept which alone made London credits effective in those days, in the eyes of negotiating banks and beneficiaries. Therefore, though the London bank simply confirmed the credit of some less well-known bank, the fact that it was the confirmation of the obligation of another bank dropped into the background. In some instances, and particularly in the case of credits issued, like that of the Credito Italiano in Figure 7 (page 50), by a London branch for account of some other office, the identity of the local bank or branch for whose account the operation was undertaken was even permitted entirely to disappear.

There is no reason, even today, from the British point of view, why the obligation of a British bank, whether in sterling or dollars, needs bolstering up by the addition of the obligation of an American bank. That

is sound reasoning. It is nevertheless a violation of the old English practice, and of the English language, to term a London bank credit, which undertakes irrevocably that drafts will be honored at the banking house of its American correspondent, a "confirmed" credit, unless the American correspondent confirms that the drafts will be honored, just as the English bank did for American banks in the old sterling credits. It is an irrevocable, uncancelable credit, as sound as the British bank. It is in form similar to the confirmed credit that the London banks formerly issued for the American banks. But it is not a confirmed credit, because it lacks the confirmation of the drawee. The old credits were termed "confirmed" because the proposed drawee undertook to accept. The credit just outlined is not confirmed, because the confirmation or undertaking of the proposed drawee is lacking.

The bankers' credit which Mr. Spalding has chosen for his illustration is a true confirmed credit. He uses as his example a credit opened for a London importer by his bank, which he terms the "city" bank. The city bank in turn asks the London branch of the Indian bank to advise out the credit. The language of the advice given by the bank in India to the beneficiary is that it is "instructed to negotiate his bills." This is by its term something more than an advice—in fact Mr. Spalding distinguishes it from an unconfirmed credit by stating that the latter is merely an advice. It seems a fair statement, therefore, to say that the principle of confirmation is carefully adhered to in British practice, and that the misunderstanding is simply one of nomenclature.

The Continental Use of the Terms

The continental banks, like the English banks, refer to "confirm" and "irrevocable" as synonymous terms, but

they, too, are careful to preserve the distinction in practice. Moreover, they are entirely in agreement with the American idea that a notifying bank, if asked to advise a confirmed credit, is expected to lend its credit also to the beneficiary. On this point a prominent Dutch bank has this to say:

We always advise the beneficiaries of the opening of documentary credits. In case you wish us to "confirm" them to the beneficiaries we shall be pleased to receive your special instructions to that effect, together with your statement for what period the credit will be irrevocably valid. It should be added that in this case the credit can only be altered or revoked if approved by the beneficiary, and that an extra commission will be charged for confirming such credits, according to a decision of the Bankers Association. If we are without your instructions to open a credit irrevocably we shall advise the beneficiaries without any liability on our part.

A similar idea is expressed by a leading Danish institution:

In order to avoid misunderstandings we beg to call your attention to the following differences between unconfirmed and confirmed (irrevocable) credits, and we urgently request you kindly to give us exact orders in that respect:

1. Unconfirmed credits will ordinarily, when the beneficiary is domiciled in Denmark and his address is known to us, be advised without obligation, either per telephone or by letter, although we do not acknowledge that we are compelled to do so; such credits may be cancelled at any time.

2. Confirmed credits (i.e., irrevocable) on the contrary will be advised the beneficiary in binding form, so that cancellation or alteration of the original stipulations of the credit before expiration of the validity, which must always be given, cannot take place without the consent of the beneficiary.

A French bank says:

In France it is customary, when a correspondent advises us of the issue of a documentary Letter of Credit, to consider it as a

Confirmed Credit, that is to say, Irrevocable, which cannot be canceled, except by agreement between the purchaser and the seller.

With regard to Unconfirmed Credits, that is to say Revocable Credits, these may be canceled directly by the person who gives the order. In the first case, as the liability of the bank is greater, we charge a commission described as being for "confirmation" in addition to the documentary commission.

The German practice is in accord with that of its neighbors.

This universal continental practice for a confirming bank to charge an extra commission for the risk assumed in lending its credit to the beneficiary for account of an opening bank is not in general use in England. It is growing here, and is likely to come into general employment in this country.

The Conflict Is Merely in Nomenclature

In all the discussion concerning the meaning of confirmation there is no *casus belli*. The only violence that is done is to the dictionary. However, to clarify the basic agreement in principle it will be necessary to adopt a common nomenclature. The restricted meaning given to the term "confirmed" in the United States appears to coincide more closely with a sound theory of commercial letters of credit, and should presently result in the term being similarly used elsewhere.

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CHAPTER VI

THE CONSEQUENCES OF HAPHAZARD GROWTH

Effect of Declining Exchanges

Some foreign credit practices were potential with disaster before we adopted them. Other dangerous practices resulted from the haphazard development of the commercial credit business in this country under the hurried pressure of war conditions. The possibilities of disaster did not, however, immediately manifest themselves. So long as the war and the postwar period of inflation kept prices on the ascendant, buyers had no thought of seeking pretexts on which to base the cancellation of their contracts. In 1919, however, even while merchandise values were still firm here, foreign buyers were finding their purchases unprofitable. During the war the pound sterling had been "pegged," and the French franc and the Italian lire supported to a lesser degree, through purchases by the governments concerned of any excess offerings which might otherwise have depressed the market. With the withdrawal of this support these exchanges sank. Foreign merchants who had opened dollar credits and had failed to purchase the dollars to cover found when the merchandise arrived and it was time to reimburse the issuing banks for the dollars which had been paid to the American beneficiary, that the decline in the value of their currency had more than wiped out their expected profit. There was every incentive, therefore, to insist upon technicalities which had

hitherto been ignored. To make matters worse, there came about this time a depression in merchandise values abroad, for which we cannot shirk our share of responsibility. Large volumes of foreign orders which had been on the books of our merchants and which had been neglected, delayed, or even forgotten during the period in which more money could be made from filling domestic orders, were resuscitated and filled after domestic prices had gone down and dollar exchange had gone up. The simultaneous arrival of those shiploads of merchandise in foreign ports depressed prices, impaired credit, and resulted in the refusal of goods and the dishonor of drafts.

The Shipping Date

As a market approaches such a period of decline, the time of delivery takes on increased importance. A quick shipment may enable the buyer to get his wares distributed while the price remains steady; a delayed delivery may expose him to the full rigor of the decline. In 1919 this question of shipment within the agreed time came to be of the essence of practically every mercantile transaction. It grew more and more to be the practice of buyers to seek to secure themselves in this regard by inserting a shipping date in the stipulations of commercial letters of credit. This date sometimes coincided with, but more frequently antedated by a short period, the expiry date of the credit.

Evidence of Shipment

The presence of a stipulated shipping date in a commercial credit puts the burden on the shipper of presenting, and on the paying or negotiating bank of examining, some evidence of shipment. What this evidence was to be, the credit instruments did not stipulate. It was generally as-

sumed, however, up to the postwar period now under discussion, that the date of the bill of lading provided the required proof. In the autumn of 1919, however, a French bank, under pressure from its customer, declined to honor a payment made by a New York bank, on the ground that the document presented, which was in a form that had come to be currently used as a contract of ocean carriage, was not a bill of lading.

The Elements of a Bill of Lading

A hurried consultation took place between counsel for the larger New York banks, and an analysis was made of the forms of shipping documents which were being tendered to and accepted by these institutions. In considering the matter counsel were hampered by the fact that there was no agreed definition of the term "bill of lading." The phrase as defined in Benedict's Admiralty is as follows:

> The written acknowledgment of the reception on board of a particular vessel of a particular quantity or parcel of goods, to be carried to a particular place is a bill of lading.

This definition appeared, however, in practice to have been extended so as to include a written acknowledgment of the reception of goods within the custody or control of the ship, although not actually on board. For instance, an acknowledgment that the goods had been received on the dock, the vessel then lying alongside, or on a lighter in control of the vessel, for delivery to the ship, seems to have been regarded by our courts as constituting a sufficient bill of lading. However, to create a lien on the ship, the bill of lading must acknowledge that the goods are received for transportation on a particular vessel. If it permits the

carrier to transfer the goods to another or following ship the instrument does not create a lien. An analysis of thirteen bills of lading, picked at random from those issued by steamship companies operating from the port of New York, disclosed the fact that each one permitted shipment on a vessel other than the one named, thus depriving the holder of the protection afforded by an action in rem against the vessel itself, which in admiralty law is known as a "libel." None acknowledged receipt of the goods on dock, on board, or in words equivalent. In only six instances was there a statement that the vessel named in the bill of lading was then in port. In view of the serious and far-reaching consequences that this state of affairs might have upon the banks, it was thought advisable to seek concerted action upon the subject.

The Conference

Early in January, 1920, a representative of counsel and a member of the staff of each of ten New York banks, trust companies, and private bankers doing an international business, met and appointed a committee. This committee addressed a letter to the leading steamship lines operating in the port of New York, calling their attention to the fact that the question had arisen as to whether banks which were directed by export letters of credit to make payments against bills of lading were protected in making such payments against the documents then issued as such by the steamship companies, which expressly gave them the right to ship the goods by a steamer other than the one mentioned in the bill of lading and which in many cases did not acknowledge receipt of the goods on board, or even on dock. The banks stated that while they could not continue indefinitely to assume the risk involved in accepting such documents, they regarded it as being in the public

interest to defer any change of policy until after conference with the representatives of the ocean carriers. These letters resulted then in the subject being taken in hand, from the transportation aspect, by the Transatlantic Associated Freight Conference, which appointed a committee to consult with the bankers. Several joint meetings of the bankers' and shippers' committees were held before a common ground was found on which to reconcile the bankers' request for the traditional form of bill of lading and the transportation companies' insistence that modern transportation conditions compelled some modification of the older form. The position of the ocean carriers, and the proposition which was eventually accepted as a solution, were set forth in the following letter to the bankers' committee:

Referring to the meeting of the Committee appointed by the Transatlantic Associated Freight Conference with your Committee on February 17, 1920, at the office of Messrs. Shearman & Sterling, the Steamship Conference confirms the statement of its Committee that the procedure in this port of issuing Bills of Lading against the receipt of goods on the steamship company's dock, which bill of lading acknowledges receipt of the goods for transportation by a named steamer, and failing shipment by said steamer, with liberty to ship in and upon a prior or following steamer, is the only procedure possible under conditions existing here, and that it is not possible here to issue on board bills of lading.

Export cargo moves through this port and indeed through all North Atlantic ports in large part from interior points. It passes from the railroad or other inland carrier into custody of the steamship company usually by lighters. Local cargo is delivered by trucks at such time as is convenient to the shipper. Cargo from inland points moves either on through or local bills of lading issued by the railroads at the point of origin, and in the case of through bills of lading, it is rare for any particular ship to be named for the ocean transportation. Any interruption or delay of this flow of cargo causes congestion and sometimes railroad embargoes on the port and exposes the shippers to demurrage charges.

The steamship lines are compelled by these conditions to provide shedded piers at great cost to themselves and to receive and become responsible for the goods considerably in advance of loading on the ship, and necessarily with more or less uncertainty as to the particular steamer by which the goods can go forward. The necessities of proper stowage and the irregularity in arrival of shipments combined with the great accumulation of cargo, both inward and outward, on the Piers, and for different steamers, render it physically impossible either to guarantee loading by a particular steamer or to determine, until after a steamer is loaded and the dock checked up, whether any specific cargo has been loaded. These are the conditions which have made necessary the present form of B/L, which has evolved from the necessities of commerce in this, and generally in all other American ports.

Regular Lines, such as the Conference Lines, with regular and frequent sailings, through their ability to forward goods shut out of a particular steamer by other steamers sailing soon after, keep the goods moving forward with the greatest expedition the circumstances permit. A limitation in freight commitments or Bills of Lading exclusively to a named steamer or to on-board Bills of Lading would involve delays and detentions and render it impossible to conduct the business under these conditions, and would result in great loss to all concerned.

The Steamship Companies feel that the Banks' difficulties are due primarily to the desire of foreign buyers to be able to repudiate export sales contracts, actually for the reason that the market or exchange has gone against them, but ostensibly on a technical interpretation of the word "shipments," contrary to the general understanding of that term here. Many sellers at present fail to adjust their contracts to conditions here, and it is suggested that the simple way out of the difficulty would be for the sellers here to arrange their contracts to conform to these conditions and that the Banks use their influence to induce them to do so, and to induce their foreign correspondents in future to modify their instructions so that the banks will feel at liberty to accept the customary steamship "Received for Transportation Bill of Lading."

It is believed that the plan suggested in behalf of the Bankers' Committee for an on-board endorsement of the B/L after the goods are loaded, would, on account of unavoidable delay, cause

serious trouble for the shippers, who would be unable in many cases to forward their documents by the ship upon which the goods go. In the hope, however, that it will lead to a readjustment of foreign sales contracts and of the form of local credits by foreign banks to conform to the conditions here, the Steamship Companies are willing after the goods are loaded, so far as reasonably practicable, to endorse on the Bills of Lading if returned for that purpose by the shippers, a dated clause to the effect that the within goods have been loaded on board, specifying any portion that has been short shipped. The attention of your Committee, however, is called to the fact that this will not be reasonably practicable in all trades, nor in any trade at all times.

The Conference Lines have been prompted to make this change in their practice by a desire to meet your Committee in any way the conditions will permit. They hope, however, that your Committee and the Bankers you represent will endeavor to use their influence to secure a change in the form of credits and in the form of export sales contracts.

Very truly yours,

(Signed) R. H. Blake
W. L. Walther
H. Connor
A. C. Fetterolf

Special Committee on behalf of the following Lines:

American Line
Anchor Line
Atlantic Transport Line
Bristol City Line
Compagnie Générale Transatlantique
Compagnie Transatlantique Belge
Cosmopolitan Line
Cunard Line
Ellerman's Phoenix Line
Ellerman's Wilson Line
Funch, Edye & Co., Inc., Lines
Furness, Withy & Co., Ltd., Lines
La Veloce
Lamport & Holt Line
Leyland Line
Navigazione Generale Italiana

Norwegian America Line
Red Star Line
Transatlantic Italiana
White Star Line
White Star-Dominion Line
Fabre Line
Holland America Line
United Fruit Company

Received-for-Shipment Bill of Lading Not an American Innovation

There has been some attempt on the part of our competitors in the world market to attach responsibility for the development and use of the received-for-shipment bill of lading upon American steamship lines and American merchants. Some of our consuls have even sent in reports in which they have set forth, without any attempt to combat them, criticisms by foreign merchants of our use of this type of contract of carriage as another evidence of the unfairness of Yankee export methods. It is worth while consequently to record the testimony of W. W. Paine, Joint General Manager of Lloyds Bank, Ltd., and a delegate of the British Bankers Association to the International Law Association Hague Conference of 1921, that the received-for-shipment bill of lading was a form of document upon which one at least of England's greatest import trades had been carried on for the past twenty years. Convincing testimony on this same subject has been compiled by T. P. Alder, Treasurer of the United Steel Products Company, to furnish an answer to claims made by British customers that by using received-for-shipment bills of lading his company was taking an advantage of foreigners such as was not taken by English exporters with respect to their foreign customers. Mr. Alder's statement follows:

Some time ago we obtained as complete as possible copies of the actual bills of lading in use by steamship companies sailing from Great Britain so that we could study them and personally ascertain the actual facts. Up to the present time we have received 96 different forms as the result of this request. We doubt, however, if this represents anything but the Liverpool, and to a certain extent, the London steamship forms, and with respect to London, only a very small proportion. It is generally conceded that Great Britain has a much larger number of steamship lines operating from Great Britain than is the case with the United States, yet our own Freight Department has furnished us with 205 specimens of United States forms and they do not claim that they have exhausted the steamship lines operating from the United States. But taking the 96 forms of steamship lines operating from Great Britain, 80 of the forms are distinctly "received for transportation" bills of lading and only 16 are "on board" bills of lading. Among the "received for transportation" bills of lading are all of the representative Transatlantic lines and it would therefore seem that if a British company, operating steamers between Great Britain and America on shipments from Great Britain, issues "received for shipment" bills of lading a British subject should not complain if steamships operating from the United States to Great Britain issue similar bills of lading, and in any event, should not assume that in the United States advantage is being taken of the foreigner which is never practiced by the Englishman.

What Is Shipment?

Along with the development of the received-for-shipment bill of lading, it came to be the belief of certain exporters that they had fulfilled their obligation to make shipment of goods to a foreign buyer by a stipulated date, by delivering the goods prior to that time to an ocean carrier and receiving a received-for-shipment bill of lading providing for their eventual transportation. Such decisions as there had been in this country, in state and federal courts, went no further than to hold that shipment was made when merchandise was delivered either on board or alongside, and a bill of lading was issued by the owners or

agents of the vessel. It was contended by certain exporters that by universal custom the definition of "shipment" had been extended as indicated. This appeared, however, to be an argument of convenience, not standing up well when applied to these merchants as importers.

Take, for example, the case of an American importer who in May, 1920, while the sugar market throughout the world was rising, contracted to purchase sugar from Java for shipment before August 30. During June and July the sugar market continued to rise and the seller in Java, being offered new contracts at higher prices, used the sugar he intended for his May contract to fill them. In August the market began to slump and the seller, finding it easy to procure sugar in Java at distress prices, purchased the required tonnage and delivered it to a steamship dock on August 30. There was no vessel in port, but a steamship company issued a received-for-shipment bill of lading. The vessel which eventually arrived in Java and loaded the sugar reached New York in January, 1921, when the market was at its lowest point. It is rather obvious that the American importer of this sugar would argue that what he intended to require, so as to reap the benefit of his transaction, was the beginning of the actual transit of the goods by the end of August, and not their delivery to a dock and the promise that they would be transported when the steamship company found it convenient. There cannot be one custom and one law for exporters and another custom and another law for importers. The banks can accommodate themselves to any settlement which merchants might desire to make of the question, but so long as merchants were permitted to blow both hot and cold on this question, as suited their convenience, the banks were bound to fare poorly—no matter from which side of the bowl they supped.

Foul Bills of Lading

In the meantime the existence of a further risk was thrown into the foreground as a result of a decision rendered on October 29, 1919, in the Court of Appeal of the Supreme Court of Judicature in London. Hannevig's Bank, Ltd., being interested on joint account with a Manchester firm in the purchase of onions from Egypt, requested the National Bank of Egypt to cable through their Alexandria office a confirmed sight credit in favor of the Egyptian supplier against delivery of "bills of lading" and other documents. The Alexandria office of the National Bank of Egypt accepted bills of lading for a shipment of 531 bags of onions bearing the notation "several bags torn and resewn." Because of the foul bills of lading, Hannevig's Bank declined to reimburse the National Bank of Egypt, which brought action for the recovery of the money paid out. The Court of Appeal reversed the decision of the trial court which had been in favor of Hannevig's Bank, Ltd., but as its judgment was based upon some unusual circumstances which had arisen in connection with the case, the judgment cannot be regarded as a precedent.

Lord Justice Scrutton, in his decision of the case, said:

> To assume that for 1/16 per cent. of the amount he advances a banker is bound carefully to read through all bills of lading presented to him in ridiculously minute type and full of exceptions, to read through the policies and to exercise a judgment as to whether the legal effect of the bill of lading and the policy is, on the whole, favorable to their clients, is an obligation which I should require to investigate considerably before I accepted in that unhesitating form.

The decision, however, was made on other grounds, and as the question had been raised but not decided, banks which issued credits were inclined to dodge the issue by

passing it on to the accredited buyer and the paying or negotiating bank. They were unwilling to agree with the correspondents which acted as their paying agents or with negotiating banks that they could receive without question bills of lading containing rubber-stamped notations of the usual sort with relation to the condition of the merchandise or its container. They were also unwilling to construe a guaranty from the beneficiary, by which he undertook to make good any loss resulting from the notations, as covering only the damage arising from the notation. They insisted on regarding such notations as evidence of an irregularity which permitted the buyer, if he chose, to reject the merchandise totally.

No Uniformity of Banking Practice

The National City Bank of New York, in an endeavor to bring its commercial credit practice as closely as possible into conformity with continental usage, had sought, by means of a questionnaire submitted to Scandinavian bankers through its Scandinavian representative, to ascertain whether there was any uniformity of practice concerning some further questions which had come into controversy. For instance, if a credit was valid until a certain date, was payment permitted up to and including the date mentioned? If a credit expired on a Sunday or a holiday, did the authority to effect payment terminate on the day preceding or the day following the Sunday or holiday? If the bill of lading was dated prior to the expiration date but presented afterward, was the beneficiary still entitled to payment? If the terms of the credit did not specify that the entire quantity of merchandise was to be shipped in one lot, were part shipments in order? The information received indicated that there was no uniformity of understanding, even among

bankers in the same locality, with regard to most of these questions. In a community as closely knit as Scandinavia twelve of the banks were of the opinion that a credit valid until a certain date authorized payment to be made up to and including the date mentioned, while five were of a contrary belief. On the question as to whether a credit falling due on a Sunday or holiday should be regarded as having terminated on the day preceding or the day following, six Swedish banks were of the opinion that the preceding day marked the termination of the credit, while only one Swedish bank took the opposite view. The Danish banks consulted were unanimously of the opinion that the preceding day should be considered the last day for payment, while in Norway two of the banks were of the same opinion and four took the contrary view.

Confusion Concerning Definition of Trade Terms

The necessity for brevity of expression in order to save expense when negotiations are conducted by cable was probably the largest contributing factor toward the adoption of abbreviated forms of export price quotations, which is another source of confusion in foreign trade circles. While these abbreviations came to be substantially synonymous, they varied somewhat according to the locality. For instance, there were manufacturers who quoted f.o.b. cars, f.o.b. works, f.o.b. mill, f.o.b. factory, or f.o.b. (named port). While confusion and controversy resulted from the use of an excessive number of abbreviated forms of this character with substantially similar meaning, more harm resulted from the use of abbreviations in a sense different from their original meaning or in a sense not ordinarily given them and different from that understood in other communities. For instance, the

quotation "f.o.b. (named port)" was often used by inland producers and distributors to mean merely delivery of goods at the railway terminal at the port named. This abbreviation originated, however, as an export quotation and had no application to inland shipment. The meaning universally given to the phrase among foreigners, therefore, was that it comprehended delivery of the goods upon an overseas vessel at the port named.

The American Foreign Trade Definitions

The matter of simplifying and standardizing American foreign trade definitions, so as to reduce the confusion and avoid the controversy which was continually arising, was taken in hand in 1919 by a conference composed of representatives of nine of the great commercial organizations of the United States interested in foreign trade—the National Foreign Trade Council, Chamber of Commerce of the United States of America, National Association of Manufacturers, American Manufacturers Export Association, Philadelphia Commercial Museum, American Exporters and Importers Association, Chamber of Commerce of the State of New York, New York Produce Exchange, and New York Merchants Association. The conference was held in India House, New York, and on December 16, 1919, as a result of its deliberations, it adopted the American Foreign Trade Definitions. There was reason to expect, therefore, that in due time these recommendations would receive such adherence on the part of American producers and distributors as to make them the standard American practice, but they did not during the period under consideration have as yet the force of law or any established practice. Consequently, although they could be resorted to by bankers as an argument in defense of the interpretation placed

by them on export quotations contained in letters of credit, they could not serve as an absolute reliance.

The Need for Regulations

All these problems pertaining to the shipping date and evidence of shipment, to foul bills of lading and lack of uniformity in contracts of carriage, to absence of uniform interpretation of the ordinary language of business and the customary terms employed to designate terms of sale, were mercantile problems. Bankers were not primarily interested in the kind of solution arrived at with respect to these problems, but they required some solution. Without it, they sat continuously in a vise, with either buyer or seller at liberty to apply the screw. The ultimate solution, by the adoption of a uniform definition of those terms which simply need clarification, and by the selection of a fair middle ground for compromise of the conflicting interests involved in the problem in which mutual considerations of benefit and detriment were factors, was, and is, a task for merchants. Yet there were, at the time these problems became acute, no mercantile agencies with a sufficiently comprehensive membership and a sufficiently adequate authority to undertake their immediate solution, and the risk was too great to delay action until proper mercantile agencies had been created and spurred to action. There was no option for the banks but to avail themselves of such materials as were at hand, and, where these were lacking, devise their own expedients for creating a workable set of regulations covering these controversial matters.

CHAPTER VII

THE REGULATIONS OF 1920 AND THEIR RESULTS

Regulations Adopted

Regulations defining the position which the banks that had participated in the New York Bankers Commercial Credit Conference of 1920 on the subject, would take on the controversial matters mentioned in the preceding chapter, in the absence of definite advice as to the position taken by their principals, were finally adopted and subscribed to by 35 banking institutions. The peculiar nature of the situation saved this action from any taint of dictation. The banks had always been ready to follow any definite instructions which had been given them. The recommendations which were adopted were expressly made applicable only in the instances in which the issuing banks or the accredited buyers had failed to indicate their attitude toward controversial matters or had employed language which was susceptible of a double interpretation. The report of the committee which had the matter directly in hand was as follows:

At a conference of New York banking institutions held at the office of Shearman & Sterling, 55 Wall Street, New York City, on January 12th, 1920, the undersigned were appointed a committee, to confer with a similar committee representing steamship lines doing business in this and other ports, with the object of adopting some procedure to avoid the risk to the banks involved in accepting as bills of lading the documents now issued as such. Your committee was also empowered to consider other commercial credit problems in which concerted action by the banks was desirable.

Action was taken which resulted in the appointment by the Transatlantic Associated Freight Conferences of a special steamship committee, consisting of Mr. R. H. Blake of the Cunard & Anchor Lines, Mr. A. C. Fetterolf, of the International Mercantile Marine Lines, Mr. W. L. Walther, of Funch, Edye & Company, Ltd., Lines, Mr. H. Connor of Furness, Withy & Company, Ltd., Lines, and Mr. John D. O'Reilly of Norton, Lilly & Company. This committee was assisted in its deliberations by a committee of counsel consisting of Mr. Charles R. Hickox, Mr. Everett Masten, and Mr. Ralph M. Bullowa. Similar service was rendered to your committee by Mr. George H. Gardiner, Mr. Carl A. Mead and Mr. Frank M. Patterson.

There were two sessions of the joint committees, at which the situation was thoroughly discussed.

The representatives of the steamship lines insisted that port conditions had necessitated the development of the form of bill of lading now in use, exception to the continuance of which has been taken, and that this form has been in common use for many years. Moreover, they contended that the consignees who had objected to its use were actuated more by the desire to escape the loss occasioned by a falling market or an unfavorable turn in exchange rates, than by the desire to be reimbursed for actual damages resulting directly from any legal insufficiency of the bills of lading. Furthermore, they asserted that the banks could secure the relief they desired by notifying their correspondents that acceptance of the form of bill of lading customarily issued in our ports, must be comprehended in all authorizations to make payments upon shipping documents.

On the other hand, your committee has been advised by its counsel that the form to which objection has been made does not create a lien upon any ship for carriage, and, consequently, lacks one of the originally important characteristics of a bill of lading. Moreover, having in mind the fact that the form fails to assure reasonably prompt shipment, an essential element in most commercial credits, your committee is of the opinion that the banks should not arbitrarily notify their correspondents that in dealing with the United States their customers must in all cases relinquish the benefit of a strict bill of lading.

The root of the difficulty, it is generally agreed, lies in the fact that the minds of the seller and buyer do not meet on the question of delivery. The seller expects to receive payment when the goods

are delivered to the steamship company, whereas the buyer expects payment to be made only when the goods are on board. The representatives of the steamship companies contend that the banks should follow the sellers' attitude. Your committee was unable to adopt this view for the reasons already stated, and deemed it necessary to insist that some means be provided to enable shippers to obtain "on board" bills of lading when necessary. The conference steamship lines have now agreed to accomplish the desired result, where practicable, by means of an endorsement on the bills of lading as outlined in their letter of March 10th, 1920.

Your committee is of the opinion that means are thus afforded to shippers to obtain "on board" bills of lading upon explicit request therefor.

In view, however, of the obvious annoyance and delay of the endorsement system, your committee recommends a communication by the banks to their correspondents, as outlined in a subsequent portion of the report. Under the practice to be established as the result of such a communication, buyers who desire to have payment effected only against "on board" bills of lading may insist upon such a requirement, but otherwise, the banks will be authorized to accept "customary" bills of lading.

In considering the whole subject of commercial credit operation, your committee has been impressed by the serious character of other unnecessary risks now being assumed by the banks, because of a similar lack of understanding between buyer and seller, and between the issuing and the paying bank, concerning the regulations and customs by which the parties interested are to be guided in their interpretation and solution of various problems which constantly arise. Your committee believes that these risks can be obviated by the adoption of uniform regulations, and subjecting all credit transactions to such regulations. We annex and submit a form of such proposed regulations. They include the recommendations of the committee with regard to the bill of lading situation.

Your committee consequently recommends:

1. The immediate adoption, by the banks comprising this conference, of the practice of requesting the "on board" endorsement on bills of lading accepted in export commercial credit operations only when explicitly required; in all other cases accepting the "customary" bills of lading.

2. The immediate adoption by the banks, comprising this con-

ference, of the regulations annexed; each bank to notify its own correspondents of their adoption, and to make the general principles of interpretation part of its commercial credit instruments by incorporation or reference.

3. The continuance of the committee in order to increase the membership in the conference, to secure the cooperation of the steamship lines not included in the report of the steamship conference, to confer with other committees and conferences on the adoption of a uniform bill of lading, and generally to consider and report from time to time upon further questions in which joint action would appear advisable.

FRANK E. J. BOWER
ERNEST H. KUHLMANN
JUNIUS S. MORGAN, JR.
EDWIN T. RICE
WILBERT WARD
Committee

The resolutions which were adopted took the form of instructions by the banks to their foreign correspondents and as thus addressed were as follows:

Payments under Export Commercial Credits advised to the undersigned are made in conformity with the following regulations, which are in accord with the standard practice adopted by the New York Bankers Commercial Credit Conference of 1920:

1. We assume no liability or responsibility for the form, sufficiency, correctness, genuineness or legal effect of any documents, or for the description, quantity, quality, condition, delivery or value of the merchandise represented thereby, or for the good faith or acts of the shipper or any other person whomsoever; but documents will be examined with care sufficient to ascertain whether on their face they appear to be regular in general form.

2. We will interpret the terms "documents," "shipping documents" and words of similar import, as comprehending only ocean bills of lading (sailer bill of lading included) and marine and war risk insurance, in negotiable form, with invoices.

3. Unless specifically otherwise instructed, we will accept "received for transportation" bills of lading in the form customarily issued in New York. (The steamship lines constituting the

Transatlantic Conference state that the customary procedure necessitated by American port conditions, is to issue bills of lading against the receipt of goods into the custody of the steamship owners or agents, for transportation by a named steamer, and failing shipment by said steamer, with liberty to ship in and upon a prior or following steamer. They state that it is not possible here to issue "on board" bills of lading, but have agreed, after the goods are loaded, so far as reasonably practicable, to endorse on the bills of lading, if returned for the purpose by the shippers, a dated clause to the effect that the within goods have been loaded on board, specifying any portion that has been "short shipped." They represent, however, that such procedure will not be reasonably practicable in all trades, nor in any trade at all times, and where used, on account of the delay involved, may result in the merchandise arriving at destination in advance of the bills of lading.) When specifically requested by a correspondent, we will request the "on board" endorsement, and obtain it, where practicable.

4. When the "on board" endorsement is not specifically requested by a correspondent, or it is impracticable to obtain it, the date of the bill of lading will be taken to be the date upon which shipment has been effected. When the "on board" endorsement is obtained, the date of such endorsement will be taken to be the date upon which shipment has been effected.

5. Instructions shall be interpreted according to our law and customs, but in any event, in accordance with the following general rules:

A. Forwarders bills of lading will not be accepted, unless specially authorized. Railroad through bills of lading will not be accepted, except on exportations to the Far East via Pacific ports, unless expressly stipulated.

B. Bills of lading shall contain no words qualifying the acceptance of the merchandise in apparent good order and condition. If "on board" bills of lading are stipulated, they shall acknowledge receipt of the goods on board a named vessel. Otherwise, "received for transportation" bills of lading, which acknowledge the receipt of the goods into the custody of the steamship owners or agents for transportation by a named steamer, and failing shipment by said steamer with liberty to ship in and upon a prior or following steamer will be accepted; and insurance certificates, if required, shall cover shipment correspondingly.

C. Documents for partial shipments will be accepted, even if the pro rata value cannot be verified, unless expressly prohibited.

D. The use of "to," "until," "on," and words of similar import, in indicating expiration, is interpreted to include the date mentioned.

E. When the indicated expiration date for payment falls upon a Sunday or legal holiday here, the expiration is extended to the next succeeding business day.

F. The terms "prompt shipment," "immediate shipment," "shipment as soon as possible" and words of similar import, shall be interpreted as requiring shipment to be effected and (if the credit advice is without expressed duration) the stipulated documents presented for payment within thirty days from the date of our credit advice.

G. Our credit advice, if without expressed duration, shall not continue in force longer than one year from its date.

H. The stipulated documents must all be presented not later than 3 p. m. (or twelve o'clock, noon, if Saturday), on the indicated expiration date.

I. The terms "approximately," "about," or words of similar import shall be construed to permit a variation of not to exceed ten per centum.

J. Definitions of Export Quotations will be those adopted by The National Foreign Trade Council, Chamber of Commerce of the U. S. A., National Association of Manufacturers, American Manufacturers' Export Association, Philadelphia Commercial Museum, American Exporters' and Importers' Association, Chamber of Commerce of the State of New York, N. Y. Produce Exchange, and New York Merchants' Association, at a conference held in India House, N. Y., on December 16, 1919.

6. Correspondents will understand that the above regulations shall govern in all credit transactions in the absence of other specific agreements. If the beneficiary shall make representations, or shall offer security, satisfactory to the bank, that no loss shall result to its correspondent or client by the waiver of any such regulations or any instruction, the bank reserves the right to make such waiver, and shall recognize no claim in the premises unless substantial direct damage shall be shown to have resulted.

Over 30,000 copies of these regulations and of the definitions of export quotations referred to in the regula-

tions were distributed individually by the conference members to their various correspondents throughout the world.

Protection Afforded by the Regulations

There is no way to calculate the amount of controversy and dispute which was prevented by the adoption of the regulations. Some approximation, however, of the protection they afforded all parties concerned by the elimination of possible points of dispute can be arrived at by considering for a moment the subsequent history of one of the topics. The regulations effectively terminated disputes, so far as the question of evidence of shipment was concerned, by stating that in the absence of instructions to the contrary a received-for-transportation bill of lading would be accepted and that the date of such a bill of lading would be regarded as the date of shipment. The buyer, on the other hand, was afforded adequate protection by the agreement secured by the conference from steamship companies, comprising the Transatlantic Associated Freight Conference which afforded him the opportunity to authorize payment, if he preferred, only against receipt of a bill of lading bearing an indorsement that the goods had been loaded on board. There is no record of any controversy having arisen between any parties concerned regarding these provisions, which appear to have worked out with absolute fairness to buyer, seller, and the banks, alike. On the other hand, in the cases in which there has been no such agreement there has been an endless amount of confusion and litigation between the various parties concerned in the transactions, which has at present thrown the question of what constitutes a bill of lading and what constitutes evidence of shipment into utter confusion.

In this country this question arose in connection with the case of Vietor v. National City Bank of New York. The beneficiary of the credit contracted to sell tin plate to a Spanish customer on a c.i.f. basis for shipment "within October 15," and the buyer established a commercial credit with that stipulation through the National City Bank in favor of the seller. Around the middle of October there was no vessel in the port of New York loading cargo for Spain. There was a shipping company operating vessels over a triangular route, Spain to Havana, Havana to New York, and New York to Spain. At the time there was a vessel in Havana which, after unloading there, was to proceed to New York and load for Spain. On October 15, however, the vessel had not yet reached the port of New York. The beneficiary, nevertheless, delivered his merchandise to the shipping company, which received it on its dock and issued a bill of lading reciting that the merchandise was "received for shipment." This bill of lading was presented to the National City Bank and payment demanded on the ground that the bill of lading in question, dated October 12, evidenced shipment within October 15. At the trial of the action, half a dozen exporters testified that it was the universal custom in the port of New York to regard shipment as having been effected when the merchandise is delivered to a dock and a bill of lading issued, providing for its eventual transportation. On the other hand, a steamship operator and three freight forwarders, called on behalf of the defendant, testified that such a practice was not universal, nor commonly recognized by merchants who were mindful of their reputation. As the jury found for the defendant, it is apparent that they did not regard the existence of the custom as having been proved.

The English Cases on Bills of Lading

More recently still the question of the status of the received-for-shipment bill of lading has come up for decision before English courts, with varying results. In the case of Marlborough Hill v. Cowan (1921, 1 App. Cas. 444) it was held by Lord Phillimore, who delivered the judgment of the Judicial Committee of the Privy Council, that there could be no difference in principle between the owner, master, or agent acknowledging that he had received the goods on his wharf or allotted portion of quay, or his storehouse awaiting shipment, and his acknowledging that the goods had been actually put over the ship's rail. Lord Phillimore said:

> The two forms of a bill of lading may well stand, as their Lordships understand that they stand, together. The older is still in the more appropriate language for whole cargoes delivered and taken on board in bulk; whereas "received for shipment" is the proper phrase for the practical business-like way of treating parcels of cargo to be placed on a general ship which will be lying alongside the wharf taking in cargo for several days, and whose proper stowage will require that certain bulkier or heavier parcels shall be placed on board first, while others, though they have arrived earlier, wait for the convenient place and time of stowage. Then as regards the obligation to carry either by the named ship or by some other vessel; it is a contract which both parties may well find it convenient to enter into and accept. The liberty to tranship is ancient and well established, and does not derogate from the nature of a bill of lading; and if the contract begins when the goods are received on the wharf, substitution does not differ in principle from transhipment. . . . Their Lordships conclude that it is a bill of lading within the meaning of the Admiralty Court Act, 1861.

There the matter stood until July, 1921, when Mr. Justice McCardie, in the King's Bench Division of the High Court of Justice, decided that the so-called

"received-for-shipment" contract of carriage was a mere receipt for goods which at some future time, and by some uncertain vessel, were to be shipped, and that it was not intended to be termed a "bill of lading." The action was brought by the Diamond Alkali Export Corporation against F. Bourgeois of London, to whom the plaintiff had sold by written contract 50 tons of soda ash. The terms of sale called for "shipment September/October from American seaboard; payment, cash against documents, under confirmed banker's credit at London; price c.i.f. Gothenburg." The contract contained this provision, "date of bill of lading is to be considered date of shipment." The buyers rejected the documents upon the grounds, among others, that a proper bill of lading and a proper policy of insurance were not presented.

Mr. Justice McCardie in giving his decision referred to Lord Phillimore's opinion in the Marlborough Hill case, but, as a Privy Council advice was not binding on the King's Bench Division, chose to disagree with it, and particularly with the portion of Lord Phillimore's opinion which has been quoted. On this point Mr. Justice McCardie said:

With the deepest respect I venture to think that there is a great difference between the two, both from a legal and business point of view. Those differences seem to me clear. I need not state them. If the view of the Privy Council is carried to its logical conclusion, a mere receipt for goods at a dock warehouse for shipment might well be called a bill of lading. At page 452 of the Report the Board say, "Then as regards the obligation to carry either by the named ship or by some other vessel, it is a contract which both parties may well find it convenient to enter into and accept. The liberty to tranship is ancient and well established, and does not derogate from the nature of a bill of lading, and if the contract begin when the goods are received on the wharf,

substitution does not differ in principle from transhipment." I do not pause to analyse these words. I only say that in my own humble view substitution and the right of transhipment are distinct things and rest on different principles. The passage last cited can, I think, have no application at all to a c.i.f. contract which provides for a specific date of shipment. It will suffice if I say two things, First, that in my view the "Marlborough Hill" case does not apply to a c.i.f. contract such as that now before me. Secondly, that grounds for challenging the dicta of the Privy Council will be found in Article 22 and the notes and cases there cited, in Scrutton & Mackinnon, 10th Edition as to what are called through bills of lading, in the lucid article in the Law Quarterly Review of October 1889, Vol. 5, page 424, by Mr. Bateson, K. C.; and of July 1890, Vol. 6, page 289 by the late Mr. Carver, and in Carver on Carriage, notes to Article 107. I do not doubt that the document before me is a "shipping document" within the U. S. A. Harter Act, 1893. I feel bound to hold, however, that it is not a bill of lading within the c.i.f. contract of sale made between the present parties.

In the same judgment Mr. Justice McCardie overruled what had been said by Mr. Justice Scrutton in his book on "Charter Parties" and what had been declared by Mr. Justice Bailhache in Wilson Holgate and Company (1920, 2 King's Bench Division) by holding that a certificate issued by an insurance company incorporating the terms of a floating policy issued by that company to the insured could not be tendered as the equivalent of a policy in connection with a c.i.f. sale.

The British Attempt at a Solution

So far as our own export commercial credit business was concerned, both these questions had been adequately covered by the Regulations of 1920—the question of shipment by the provisions already referred to, and the question of insurance certificates by the American Foreign Trade Definitions, which define c.i.f. documents as com-

prehending "insurance policy and/or negotiable insurance certificate." These regulations, however, afforded no comfort or protection to the British banks which were negotiating dollar drafts drawn under American bankers' import credits, or accepting for American bankers drafts drawn under sterling credits. American bankers had refrained from incorporating the regulations in their import credits for fear that their inclusion would render negotiation of drafts more difficult. The effect of exclusion was quite to the contrary.

Far Eastern banks had felt the effects of the uncertainty which had been created in the minds of merchants by the abuses which were possible in connection with the received-for-shipment bill of lading. The Foreign Exchange Bankers Association in Shanghai, in November, 1920, agreed in the future not to accept received-for-shipment bills of lading in connection with bills of exchange drawn against American credits. Even prior to that time the exchange banks of Batavia, because of the reported refusal of the American banks to recognize received-for-shipment bills of lading, had bound themselves not to buy after September 1, 1920, drafts drawn against such letters of credit unless accompanied by the written or telegraphic declaration of the American banks in question, showing that they agreed to accept received-for-shipment bills of lading.

This action, it will be observed, was taken simply in connection with American bank credits, which were thereby discriminated against in favor of British credits, on the assumption, apparently, that the British merchants were ready to accept the received-for-shipment bill of lading. The subsequent British litigation which has been just set forth indicates the fallacy of this position. British bankers consequently have had to come around to the

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position which New York bankers took in 1920, by recognizing the fact that the buyer should be able to indicate which sort of bill of lading he desires, and that the seller should be afforded an opportunity of obtaining the sort that the buyer has indicated. At the present time the British Bankers Association has reached the opinion that the use of the shipping document known as the "received-for-shipment" bill of lading, and like documents, have become in many cases a necessity of commerce. They have consequently recommended that the interests concerned co-operate to remove the difficulties which at present attend the use of such documents in the cases in which their need is generally recognized.

How this co-operation is to be attained has not yet been determined. It has been proposed that the solution follow the plan which was adopted in connection with the Liverpool Bill of Lading Conference Committee, which produced regularity in the handling of cotton shipments by sanctioning and defining custody and port as well as ship bills of lading. It has been proposed that two classes of bills of lading be established: first, a "shipped" bill of lading, which would be an absolute guaranty of shipment in the named steamer, and, second, a received-for-shipment bill of lading, which would be a guaranty: (1) that the goods named had irrevocably passed out of the shipper's control and were entirely at the disposal of the carrier, and (2) that the named steamer was expected to be either in the port ready to commence loading or to complete loading, and to sail from the port within an agreed number of days from the date of the bill of lading. It seems that a more pràcticable solution could be accomplished by limiting the use of the received-for-shipment bill of lading to carriers of undoubted responsibility, with adequate facilities for receiv-

ing and warehousing the merchandise pending shipment, and operating regular sailings over established routes with sufficient frequency to insure freedom from undue delay.

It seems at the present time to have escaped the attention of British and Far Eastern bankers that there is a difference between the shipped bill of lading they are at present demanding and the bill of lading with an on-board indorsement, which is obtained upon request in American ports. The Amercian indorsement actually evidences a receipt of the merchandise on board the vessel named, while the so-called "shipped" bill of lading, which is now in use by the British lines operating in the Far East, is actually nothing but a received-for-shipment bill of lading under another name and affords the buyer no more protection than formerly. The typical language of a received-for-shipment bill of lading reads as follows: "Received in apparent good order and condition for shipment on board the steamer .... with liberty to substitute any other or succeeding steamer." At the present time it is the practice to convert such a bill of lading into a shipped bill of lading by striking out "received for shipment" and inserting the word "shipped," leaving, however, the liberty of substitution. Consequently, while American banks have on export credits been freed from risk or controversy in connection with the question since 1920, the total effect of the British efforts, through litigation and bank action, has been to heighten rather than to lessen the confusion in Great Britain.

Lack of Uniform Contract of Carriage

The principal function of a bill of lading, as between shipper and carrier, is to serve as a contract of carriage, and as such its terms are of interest simply to the contracting parties. When, however, a bill of lading comes

to be used as an instrument of credit, furnishing documentary evidence of the shipment of goods from seller to buyer, and purporting to vest control of the merchandise in the hands of the holder of the bill of lading, it takes on a public character. It must be safeguarded against fraud and standardized, so that each bill of lading presented to a banker as security need not be minutely analyzed to ascertain its legal sufficiency. The bills of lading issued by our rail carriers in interstate commerce have attained this desirable status and have become readily adaptable to large-scale banking operations. This situation did not result naturally, but was brought about through the continuous efforts of the American Bankers Association. At the present time it is not necessary for a banker to examine a railroad bill of lading because the Interstate Commerce Commission has prescribed the form uniformly employed by every carrier, while the Federal Bill of Lading Act defines the kinds of bills of lading which may be issued and fixes their legal effect.

Our commerce is international as well as interstate, and it is quite as important to the commercial as well as to the banking community that this standardization should be effected in the bills of lading employed in foreign commerce. However, the situation with regard to ocean bills of lading is today as chaotic as that which existed with regard to railroad bills of lading at the time when pressure was exerted which has resulted in the clarification of the domestic situation. The only uniformity reached by ocean bills of lading at the present time is a rough sort of uniformity of non-responsibility which has been accomplished as a result of each line having adopted any liability-waiving clause that has been worked out by counsel for their competitors and inserted in their bills of lading. While up to the present time, out of all the

plans drawn up by committees and conferences which have been called to discuss the adoption of uniform ocean bills of lading, nothing which promises the hope of an immediate solution of the problem has resulted, there is under way an international movement which, if successful, should form the prelude to complete uniformity. At a meeting of the International Law Association at The Hague on September 3, 1921, an international code, defining the risk to be assumed by sea carriers under a bill of lading, was adopted. This code has already been adopted by the British Bankers Association, which agreed to make them effective in relation to all transactions originating after January 31, 1922. It is likely that similar action will be taken by the American Bankers Association. Such opposition as has developed has been directed to what are after all secondary considerations. The precise form of a carrier's bill of lading or the precise point at which the carrier's liability ceases and the cargo underwriter's begins, is not the important question. The vital thing is that obligations and forms should be uniform. Then, and then only can all parties protect themselves intelligently, and the party who accepts a known risk can always cover himself by insurance, and double insurance can be avoided. It seems advisable, therefore, that the principle of uniformity as put into effect by The Hague Rules, 1921, should have universal approval, and if necessary the question of the precise adjustment of the division of responsibility effected thereunder should be left to subsequent negotiation.

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CHAPTER VIII

RECOGNITION OF THE NEED FOR STANDARD FORMS

The Beginning of the Movement

While it was the favorable reception given to the Regulations of 1920, because of the protection they afforded all parties concerned, which encouraged the thought that complete standardization of commercial letter of credit forms might be accomplished by unified action on the part of bankers who dealt with the device, the advantages to be gained from such a course had previously been set forth by merchants. *The Bankers Magazine* of August, 1917, contains an article by J. P. Beal, of the American Steel Export Company, which bears the title, "Utility of Letters of Credit in the Export Trade—a Plea for Standard Forms." Mr. Beal said, in part:

When the letter of credit has been established the exporter is then desirous of knowing that the terms of it are such as to give him adequate protection. In this regard it is interesting to note the many different forms used by the various banks; they all seem to be different in some respects. Some banks merely write an explanatory letter on their regular letterheads, while others have forms set up on which to record the various points in relation to the terms of the credit. When one considers the vast number of these daily transactions by all the banks having foreign departments or foreign correspondents of any importance it would only seem natural that some concerted action be taken by the banks to standardize, as much as possible, the forms for reporting letters of credit. Checks, drafts and notes have been standardized on uniform lines—why not letters of credit? The uniform bills

of lading adopted by the railroads of the country have materially assisted both the shippers and the carriers in a more thorough understanding of the conditions and protection afforded to each.

There are always certain points in regard to a letter of credit about which the export merchant is vitally concerned, and if the letter from the bank does not clearly specify some of these it means correspondence between the two to clarify the point in question. This correspondence takes a considerable amount of time both of the merchant and the force of the bank. A great portion of it might be eliminated with an increase of efficiency and reduction of expense to both. Would these points not usually be more fully and clearly stated—and be more susceptible of proper interpretation, if standard forms were adopted?

The first effective work towards the accomplishment of this end was performed by Omer F. Hershey, a member of the Baltimore bar and general counsel for the American Steel Export Company, who wrote for the *Harvard Law Review* of November, 1918, a thoughtful analysis of all the body of law then extant on the subject of letters of credit, in order to find the legal basis upon which standardization could be built. After examining various conceptions with regard to letters of credit which have been suggested in certain court decisions, Mr. Hershey reached this conclusion:

But all the requirements of the situation are met and on the whole are better met by treating the letter of credit as a self-sufficing instrument of the law merchant. In the end nothing will do so well as a frank and full recognition by law of the universal understanding of the commercial world. To bring this about, bankers should agree on a simple, uniform letter, and the courts should give effect to it for what it is intended to be. Perhaps the timid, not to say false, conservatism of the courts may compel business men to turn to the Commissioners on Uniform State Laws and invoke the aid of the legislator. But legislation cannot come in time to take care of the litigation that is almost certain

to flow presently from the enormous volume of business done under these letters in the last four years. The courts may, if they will, do all that is needed; for, I repeat, it is a false conservatism that stands in their way. Courts are properly cautious in abandoning rules or doctrines, since to do so may endanger the stability of our economic order by disturbing the transactions of the past and unsettling acquisitions; but there is nothing truly conservative in adhering to conditions of uncertainty in the laws governing commerce, or in defeating or unsettling business transactions, carried on in large volume, by insisting on applying to them doctrines or theories developed for earlier and different conditions of trade, or in disturbing credit by making it uncertain whether the deliberate promises of business men made in the course of business as business transactions, and in practice relied upon with confidence in the every day course of our commerce, are to be legally enforceable. In the words of Cockburn, C. J.,—

"Why is the door to be now shut to the admission and adoption of (commercial) usage, as though the law had been formally stereotyped and settled by some positive and peremptory enactment? . . . . Why is it to be said that a new usage which had sprung up under altered circumstances, is to be less admissible than the usages of past time?"

Let us hope that New York, where most of these questions are likely to rise, will prove capable of finding another Kent upon her bench in this twentieth century—when her commercial interests and the commercial development of the country at large call for him no less than did the opening years of the nineteenth century. Lord Mansfield sought to establish a doctrine that no promise in writing made by a business man in the course of business could be held nudum pactum. Is it not time that business transactions in our law should stand as such and be entitled to legal protection because they are such, without the necessity of continually giving them artificial forms in order to comply with historical requirements of consideration, and without the risk that they will fail because business has chosen to grow along its own lines instead of hewing eternally to some fixed line of common-law doctrine or tradition? Commerce is able to function safely on the theory that "a business man's word is as good as his bond." Our courts can afford to make this plain theory of business an effective theory of law.

This article was reprinted by the American Steel Export Company and distributed with the following note signed by Howard W. McAteer, its president:

The American Steel Export Company takes the liberty of calling your attention to the following article on "Letters of Credit" from the Harvard Law Review. Our Company, particularly since the beginning of the war, has used such letters to the extent of many millions of dollars, but often with some hesitancy and uncertainty as to our legal and practical position under given contingencies. In fact the article here called to your attention is really the outgrowth or elaboration of opinions given our Company from time to time on its own Letters of Credit problems, by Mr. Hershey, our General Counsel; and while the paper is rather technical and intended for lawyers only, nevertheless some parts of it will be of interest I think to you, as bringing out the desirability of having our financial houses adopt a more simple standard form of Letter that meets the legal requirements and at the same time is satisfactory to business. Mr. Hershey shows up the chaotic and uncertain state of the law on the subject and argues that the courts should treat a letter of credit so as to give effect to what business intends and means and understands by it. To ask the courts to do what seems to me to be so obviously proper, presupposes that business men and banks have done their part to simplify and standardize these documents and to make sure that they themselves always know what is intended by them. Our experience is that at present hardly two institutions issue the same form of letter. Some differ in form only, others in legal substance also. The result is just the sort of confusion and uncertainty this article points out. None of us know to what extent the present use of these letters may continue, but I think they might well be of service in our post war overseas business, if their position, both legally and practically, could be more clearly established; and I trust this discussion of one phase of the subject may be of interest to you.

In the spring of 1920 the subject engaged the attention of Marc M. Michael, Treasurer of the Consolidated Steel Corporation, who sought, unsuccessfully, to have

the New York Bankers Commercial Credit Conference consider it at that time and brought it before the Seventh Annual Foreign Trade Convention held that year in San Francisco.

Survey Made by Federal Reserve Board

In the fall of 1920, Dr. H. Parker Willis, Director of the Division of Analysis and Research of the Federal Reserve Board, assigned his assistant, Dr. George W. Edwards, to co-operate with the New York Bankers Commercial Credit Conference in carrying forward the work in which the bankers had made a promising beginning by their regulations of that year. Dr. Edwards laid the groundwork for a scientific study of the subject by making a survey of the forms and practices of American banks, and by obtaining expressions of opinion from American exporters and importers on the controversial problems relating to the technique of letters of credit. The results of these exhaustive studies have appeared in the *Federal Reserve Bulletins* during 1921 and have been reprinted in convenient pamphlet form by the American Acceptance Council ("Commercial Credit Instruments and Practice in Financing Foreign Trade," by George W. Edwards, Ph.D.). The data thus secured served as the basis of the uniform credit instruments which were eventually adopted.

Enlargement of the Conference

As at this time the subject had ceased to become a matter of local interest, it was found advisable to enlarge the membership of the bankers' committee by the addition of representatives from Chicago and New Orleans banks. To give it broader support and a continued existence, the activities of the conference were, through

the friendly offices of Paul M. Warburg, put into co-ordination with the activities of the American Acceptance Council, which has undertaken to carry on the work.

Co-operation Between Mercantile and Banking Interests

While the bankers were making these preparations for the work of standardizing the forms, various mercantile associations had independently arrived at the feeling that standardization should be attempted, and had formed committees for that purpose. After informal discussion between these committees, it was determined that the work of analyzing the material obtained by Dr. Edwards and drafting proposed forms should be done in the first instance by a subcommittee of the American Bankers Commercial Credit Conference. This committee, under the leadership of E. H. Kuhlman, an assistant manager of the foreign department of the Mechanics and Metals National Bank, drafted forms which, after consideration by the Commercial Credit Conference, were submitted in June, 1921, to a joint meeting of the committees representing the various bodies interested.

First Joint Conference

The attendance at this joint meeting was as follows:

Wilfred S. Cousins	representing	American Acceptance Council.
Wm. H. Knox	"	National Foreign Trade Council.
A. W. Willmann	"	American Manufacturers Export Association.
W. H. Douglas	"	American Exporters and Importers Association.

Howard Ayres	representing	Chamber of Commerce of the State of New York.
C. A. Richards	"	Merchants Association of New York.
Marc M. Michael	"	National Association of Credit Men.
F. Hartman	"	Irving National Bank.
C. C. McCauley	"	First National Bank of Boston.
R. M. Saunders	"	Guaranty Trust Company.
Wilbert Ward	"	National City Bank of New York.
Dr. Geo. W. Edwards	"	Federal Reserve Board —Division of Analysis and Research.

Bearing in mind the basic proposition that the proper function of a commercial credit is to finance the transaction and not to serve as a check on the proper execution of the terms of the contract of sale, the joint conference examined the proposed forms, in which the rules adopted by the conference in 1920 had been incorporated, with the object of eliminating as many rules and limitations as possible. Such rules as were retained in the forms recommended by this conference remained simply because the commercial practice on the points involved had not as yet been clarified. It was pointed out that even in such cases the rules were intended to apply only where the absence of specific instructions would otherwise leave the points in question open to interpretation. It was recommended that commercial bodies here and abroad address themselves immediately to the adoption of a uniform and generally recognized custom with reference to the matters which remained the subject of regulations, so that commercial credit instruments might in this fashion

be freed entirely from the necessity of incorporating rules for their interpretation.

The Demand for a Single Type of Credit

While there was agreement between the merchants and the bankers, therefore, as to the fundamental purpose of the credit device, there was from the outset some division of opinion concerning the form the instruments should take. The interest which our merchants were giving the subject had been stimulated by the experiences they had undergone, in the spring of 1920, in connection with the dramatic collapse of our export trade. The mercantile organizations, export houses, and manufacturers who were now in search of a satisfactory bankers' credit, were frankly in pursuit of an instrument which would assure them protection against another wave of cancellation. They possessed ample financial strength to assemble merchandise and to finance it themselves through the period of overseas transit to the buyer, if they were satisfied of the credit risk. However useful a credit which took this burden of overseas finance off the seller's shoulders might be to others, it was valueless in their eyes unless there was coupled with it an irrevocable commitment, preferably by an American bank, to honor their drafts if presented within a stipulated time. Feeling on this point was so strong that some of our merchants were unwilling to concede that a credit instrument might fail to achieve the object they sought and yet be useful to others who sought another purpose. They sought, instead, to persuade American bankers to decline to issue any other instrument than the one they sought, so that foreign buyers and foreign banks would be unable to tender any other. Such a course on the part of American bankers would not be justified unless the forms

which were to be thrown into the discard were useless for any purpose whatsoever. It is worth while, therefore, to consider again for a moment the purposes a commercial letter of credit may accomplish, and contrast these purposes with the reasons which actuated our merchants in seeking credits. It is only by contrasting the purposes they sought to achieve with the instruments offered to them that some estimate can be made of the extent to which the demand for a single type of credit was justified.

Protection

At the time the commercial letter of credit came into general use in this country's export trade, the world's political and economic situation was shifting so rapidly that reliance could not be placed on ordinary credit sources. Merchants abroad were solvent one day and bankrupt the next, often through causes beyond their control. Those of our manufacturers, export merchants, and export commission houses, who had at their disposal sufficient capital and banking credit to extend terms to their foreign buyers, found their credit managers increasingly reluctant to approve the risk. They were also being approached by a flood of new customers whose right to request credit had not been demonstrated in previous dealings. In seeking commercial letters of credit these merchants were actuated by a desire to protect the credit risk. They sought the commercial credit, therefore, to relieve themselves of the necessity of extending credit to the buyer.

Aid in Financing

Prior to 1914 the bulk of the foreign trade was done by less than a dozen export merchants and commission

houses. By 1919 there were over 1,800 such houses operating in New York City alone. Few of the newcomers had capital; some had experience; many lacked both. These houses in the main had extremely limited resources for the financing of the business which was offered them. They could assemble merchandise and ship it, but at that point they had to arrange for the payment, not only of the goods to their domestic suppliers, but of the freight rates, and insurance premiums. It made little difference to these houses whether the buyer's credit risk was good or bad. The only basis on which they could do business was "cash against documents New York." They sought credits, therefore, for another legitimate reason—to place themselves in funds during the period in which the merchandise was in transit.

More Moderate Counsels Prevail

There were American merchants who sought only protection and the types of credit which afforded it, and who, while they appreciated the limitations of other forms of credit, were not only willing to concede their suitability to the purpose of other merchants, but to admit that they would at times rather have them than no credit at all, when that was the alternative the buyer offered. The American banks had never entertained the idea that standardization would be attained by dictating to foreign banks the sort of instrument they must employ in this market. Their plan, from the outset, had been to analyze existing forms and see to what small compass they could be compressed without losing flexibility. An equally great effort was made to clarify and define beyond the possibility of misunderstanding the exact function of the forms adopted as the result of this analysis. These forms continue to give the buyer and the issuing bank liberty

to offer the seller varying degrees of security. By clarifying the exact obligation assumed by the several parties concerned, these forms enable the seller to understand exactly the nature of the security he is offered, and thus to determine whether or not it is acceptable.

CHAPTER IX

THE RIGHT TO REVOKE

Does the Right to Revoke Exist?

After it had been conceded by American merchants that the movement for the unification of commercial letter of credit forms and practices should include a credit which did not afford protection against cancellation, it was still necessary, before the work of drafting forms could begin, to determine upon a policy to be pursued with reference to giving notice of cancellation. To fix upon this policy it was necessary to give consideration to what appeared to be the most disputed and least understood of all the attendant problems—that of the exercise of the right to revoke. About this question of the right to revoke or cancel—the terms are used synonymously—there has been more loose thinking and more unjustified confusion than on any other point in commercial practice.

The case against the right to revoke had its most extreme expression in a circular dispatched by a New York bank to its correspondents during the early years of the war, when American banks were doing commercial credit business first and learning how to do it afterward. The circular said:

In the case of an unconfirmed, or revocable credit, a liability exists notwithstanding the fact that it has not been confirmed; and this liability covers the ground that, after receipt of advice of the issuance of the credit, notwithstanding the fact that emphasis is laid upon the circumstance that the credit is not a confirmed one,

any action, no matter how slight, on the part of the beneficiary puts the obligation upon the bank to pay the amount of his invoices.

American Banking Opinion Divided

One of the inquiries made of American banks last spring by the very useful questionnaire devised by Dr. Edwards of the Division of Analysis and Research of the Federal Reserve Board, was this:

When you are asked to cancel an unconfirmed credit, is the maximum time limit within which you may cancel set by——

Delivery of goods at pier by exporter?
Drawing of drafts by exporter?
Negotiation of drafts by your bank?
Receiving of documents by your bank?

Dr. Edwards' analysis of the answers received is as follows:

Delivery of goods,	Yes, 2;	No, 41.
Drawing of drafts,	Yes, 1;	No, 41.
Negotiation of drafts,	Yes, 29;	No, 15.
Receiving of documents,	Yes, 18;	No, 25.

(a) If a seller had manufactured goods of a special kind in good faith on the strength of the credit, we doubt whether it could be cancelled and we believe the same condition would apply if an importer had purchased special lines of merchandise for export.

(b) All credits usually state conditions of expiration. If authority provides that shipment must be made by date, we consider that a regular bill of lading of a public carrier evidences time of shipment.

(c) We have always considered that we have the right to cancel an unconfirmed credit by giving notice to the beneficiary in writing at any time before presentation of the documents to our bank.

(d) An unconfirmed or revocable credit can be cancelled at any time by the party who had established it, providing that such

cancellation or revocation notice reaches the negotiating bank prior to the actual negotiation. Once, however, a bank has negotiated in good faith a draft drawn under an unconfirmed credit, the bank which established the credit must protect the negotiating bank.

(e) A revocable credit is subject to cancellation until the drafts are actually paid abroad regardless of time of negotiation.

It is a recognized principle that an unconfirmed credit may be cancelled by an advising bank, but the maximum time limit within which this right may be exercised is subject to various interpretations. As shown by the above answers the exact time may be fixed as follows:

(a) Completion of manufacture, particularly of special goods.
(b) Delivery of goods to a carrier as evidenced by a bill of lading.
(c) Presentation of documents to the bank.
(d) Negotiation of drafts by the notifying bank.
(e) Payment of drafts by the credit-issuing bank abroad.

The more liberal policies expressed in answers (a), (b), and (c) are followed by only a few banks, for the majority claim the right to nullify the credit at any time prior to the moment the drafts are paid—(d). Some even insist that the entire credit may be rescinded up to the time of negotiation by the original credit-issuing bank (e). A few contend that they may avail themselves of the power to cancel an unconfirmed credit at any time, without even notifying the beneficiary of such action.

The English View on Revocation

Mr. Spalding in his book on the English practice records that there is a "difference of opinion" about the right to cancel a bankers' credit. He also says:

Needless to say, there is considerable controversy about the precise reliance to be placed on an unconfirmed credit, and bankers hold that the value of such a credit is that it is valid until cancelled; but the bank has the right to cancel it whether the beneficiary agrees or not. Possibly the acceptance by the exporter of such terms as are found in the credit would be taken in law to be sufficient notice that in drawing his bills he had no assurance that

they would be accepted by the bankers upon whom they are drawn; but if there were the slightest implication that the bank had given any sort of guarantee to accept and had not reserved to itself the power of revocation, the Courts would certainly decide that the bank issuing the credit was estopped from cancelling it.

Issuing or Notifying Bank?

To what extent, and in what respects was there an actual conflict in principle in these views, and how may that conflict be reconciled? It is likely that Mr. Spalding had in mind, in his observations on the subject of cancellation, the obligation of the opening bank. Such confusion as exists in England on this subject undoubtedly arises from the fact that the existence of a "bankers' credit," so-called, which does not state whether it is revocable or irrevocable, is recognized.

The American banks, on the contrary, had been asked for their opinion about their obligation as paying banks in connection with revocable credits, opened by correspondents, and advised by them without confirmation. The wide variance between the answers given by American banks to Mr. Edwards' questionnaire is attributable to the fact that some of them had apparently overlooked this distinction, and had thought themselves bound by precedents which apply only to opening banks, and only, also, to credits which are silent on the question of revocability. This statement is based on the inference that there is a distinction between the duty of the opening and of the paying bank with regard to notice of revocation. What brings about this distinction?

The Duty to Give Notice

Thomas P. Alder, Treasurer of the United States Steel Products Company, in a thought-provoking article in the *New York Credit Men's Association Bulletin* of

January, 1922, in discussing this question of the notifying bank's duty to give the beneficiary notice of cancellation, makes this suggestion:

> There may be good reasons for cancelling a credit of this character, but there can be no reason for making the cancellation effective prior to the receipt of written notice from the bank issuing the document delivered to the beneficiary.

This is a plausible but unsound doctrine. Supppose that Beyer at the request of Benedict, who is aware that he sees West daily at a luncheon club, says to West, over their coffee: "By the way, West, Benedict asked me to tell you that he would hand me $10 to give to you, if you send him that book." Undoubtedly, Beyer would not convey this message to his friend West unless he thought Benedict would perform his promise. But on the morrow Beyer is dismayed to learn that Benedict has gone to the wall and cannot, therefore, hand him the $10 to give to West. He regretfully discloses the news to West at lunch and adds that he hopes West had not sent the book. West, rather perturbed, states that he mailed the book to Benedict yesterday afternoon. So far the example sounds rational. Now for the impossible ending!

West: "Then you must pay me $10."

Beyer (registering astonishment): "How do you figure that?"

West: "Because you failed to notify me that Benedict could not."

The statement will bear reiteration, that the notifying bank assumes no liability, and sets up none on its books in connection with its advice of a revocable credit issued by another bank. If, however, the beneficiary could, by action taken without the consent or knowledge of the

notifying bank, convert the credit into a liability of the notifying bank, then the notifying bank would have to set it up as a liability at the time the credit was advised, and the difference between it and a confirmed credit would disappear. The mere statement of this proposition destroys it.

Correspondent banks everywhere, though they recognize no responsibility to do so, usually, as a matter of course, advise the beneficiary in some fashion of the receipt of such instructions. Undoubtedly, no bank which is careful of its reputation would mail such an advice unless it were reasonably confident of the intention of the principal to have funds on hand to pay the beneficiary's draft when presented. That is, however, a wholly moral responsibility. There is no reason for the notifying bank to go beyond that point and to appraise the credit risk sufficiently to determine whether it would be willing to undertake a commitment of that amount. If the beneficiary is content to rely simply on the opening bank's revocable commitment—for that is all this type of credit purports to supply—and to accept the chance that the notifying and paying bank may not have funds of the opening bank at hand with which to pay the drafts when presented, and that its instructions to pay will remain uncanceled, he will accept the credit. If the beneficiary is not content to take this risk he should reject the credit.

A Sound English Decision

Luckily for English merchants and bankers, the question of the duty of a notifying and paying bank to give the beneficiary notice of cancellation of an unconfirmed credit has now been decided by their courts. On June 14, 1920, Lloyds Bank in London issued a credit in favor

of the Cape Asbestos Company, Ltd., containing the following footnote:

This is an advice of the opening of a credit and is not to be taken as a confirmation of same.

On August 4 the credit was withdrawn by the Warsaw Bank, which had instructed Lloyds Bank to open it, but through inadvertence the beneficiary was not advised by Lloyds Bank of this circumstance. On October 2 the beneficiary sent to Lloyds Bank documents relating to a part shipment, and when payment was refused brought suit. The action was heard by Mr. Justice Bailhache in the Court of King's Bench, who held that, while it was regrettable that the bank had neglected to inform the plaintiff that the credit had been withdrawn, the first notice given by the bank to the beneficiary was of a revocable credit, which told the person in whose favor it had been opened that he might find it revoked at any time. He came to the conclusion, therefore, that however wise and prudent, and however much in the interests of business notice of revocation might have been, there was no legal basis under which he could find an obligation of the bank to give it.

Notice by the Opening Bank

While it can, therefore, be accepted as sound doctrine supported by legal authority that the paying bank, which has assumed no liability, need take no steps to give notice of the termination of that which never existed, there are still to be considered the steps which the opening bank, which has assumed a liability, should take to revoke it. Need it give no notice whatsoever? If so, then a paying or negotiating bank would always take the risk that any payment made by it might be excepted to,

or drafts negotiated by it dishonored, on the plea that the opening bank had previously revoked the credit on its own books. Obviously, business cannot be done in that way. Will it suffice, then, for the opening bank to give notice to the bank which it has selected as paying or negotiating agent? That, it will be recalled, is exactly what is claimed by the British bank in connection with the unconfirmed credit, which is discussed in the chapter on confirmation. Unquestionably, there was no further duty in connection with that credit; but in discussing what shall be adopted as a standard practice for future use, it is pertinent to inquire whether the opening bank should, in fairness, offer a beneficiary a credit which may be revoked without notice to him.

Is there any reason to go further, and give effect to the doctrine that the beneficiary of a revocable credit, by proceeding with the execution of the order, can put the opening bank under an obligation to pay, though notice of cancellation reaches him before he has availed himself of the credit? Apparently the theory on which those have relied who have asserted this right, is that the opening bank is estopped to cancel the credit. Without going too far into legal intricacies, it may be stated that estoppel has as an essential element an untruthful representation by the party sought to be estopped, believed by the other party and relied on to his detriment. A commercial letter of credit or advice which states that it is subject to cancellation, is, if these words can be given their plain, ordinary meaning, subject to cancellation, and affords no basis, in law or common sense, for an estoppel.

Difficulty of Giving Notice

Theoretically, at least, the satisfactory way to compromise the views of those who, on the one hand, assert

that the right of revocation is non-existent, and those who, on the other hand, assert that it can be invoked without notice, would be to adopt a form of credit instrument which continued in force, so far as the opening bank was concerned, until notice of revocation were given the shipper. But theoretical solutions must, in commercial letter of credit operations, as in other business relationships, be tested by the difficulties their practical operation may create. And in this case it was the opinion of counsel that effectual notice of cancellation could be given only by stipulating in the terms of the advice that it would be conveyed by letter or telegram, directed to the beneficiary, and either delivered to him or left at the address stated at the head of the letter of credit or advice.

Of course, this is equally true of notice given by bank to bank. However, banks are not of migratory nature and so long as they continue to exist must operate every business day, through officials whose position and authority are matters of public knowledge. The exporter's business is, however, of a private nature, and the task of giving him effective notice of cancellation of a commercial letter of credit could, it is conceivable under certain circumstances, become as arduous as that of a process-server seeking an elusive witness, or a bill-collector hunting out a wily debtor. The difficulties that may arise to interfere with the timely presentation of documents have already been combined with the familiar triangle of villian, heroine, and hero, to furnish the plot for a short story, "Piracy in Reverse" by George Kibbe Turner, in the *Saturday Evening Post,* February 18, 1922. If the banks were to assume the offsetting task of giving the beneficiary notice of revocation before he could present his documents, a game of hide-and-seek might

result which could furnish thrills for a moving-picture serial.

Notice Not Given Under Present Practice

If the present-day "revocable" commercial letter of credit were in fact good until revoked, as its name would imply, banks would at present be assuming the task of giving effectual notice of cancellation to the beneficiary.

IMPORTANT NOTICE

In order to avoid any misunderstanding in regard to the credit outlined in the accompanying communication, we beg to say that this is ***not a confirmed credit*** and consequently is subject to revocation at any time, either by the parties granting the credit or by ourselves under certain conditions. In the absence of any statement to the contrary, The National City Bank of New York assumes no obligation whatsoever to make the payment, even if all the conditions of credit have been complied with.

If this is not acceptable to you please communicate with your customer and request him to have his banker amend the instructions.

Please note for your guidance that a ***confirmed credit*** is absolutely irrevocable provided the conditions of the credit have been complied with.

Figure 18. Notice Attached to Unconfirmed Credit

As a general thing, however, they have relieved themselves of this responsibility by the insertion of a clause which permits the modification or cancellation of the credit without notice to the beneficiary. For instance, there is pasted on the face of the unconfirmed credit (Figure 17, page 70) a slip reading as shown in Figure 18.

Right to Notice Without Practical Value

It has already been pointed out that even though a beneficiary had not received notice of cancellation, he would not, by presenting his documents drawn under a revocable credit to the paying bank, be assured of payment. He would thereby simply establish a basis for legal action against the opening bank. If the opening bank were sound, there would be no occasion for the paying bank to decline to effect payment, so that the most the shipper would gain by being the beneficiary of a credit, revocable, but only on notice, would be the chance to prosecute a claim against a foreign corporation or banking firm of dubious standing. This is the full extent of the shipper's gain over that which he would receive by being advised by the notifying bank that the opening bank had authorized it to pay his drafts, and that the drafts could be offered for payment before a certain date, although the advice conveyed no engagement by either bank to the shipper, and the authority was subject to modification or revocation without notice to him.

The Revocable Credit Eliminated

In the light of all these circumstances, the conclusion was reached that for practical reasons it was inadvisable to provide the shipper a revocable credit. If the shipper needs protection against cancellation, a revocable credit does not supply it. If he does not feel the need of protection against cancellation, the advice of authority to pay gives him all he requires. In proceeding to the work of drafting commercial credit instruments and advices, therefore, the committee eliminated the revocable credit from consideration, and substituted in its stead the advice of authority to pay.

CHAPTER X

THE STANDARD APPLICATION AND AGREEMENT TO REIMBURSE

The Need of Standardization

It was not contemplated at the outset that the Commercial Credit Conference would seek to regulate the contractual relationship between the opening bank and the accredited buyer by suggesting the phraseology to be employed in the form of application used by the buyer in instructing his bank to open a commercial letter of credit for his account, and of his agreement to reimburse it for the outlay authorized on his behalf. It soon became evident, however, that this ground would have to be covered also, to carry the work of standardization to complete success. If the only parties concerned in a commercial letter of credit operation were the opening bank and the accredited buyer, it would perhaps be an intrusion to restrict their liberty to fix their mutual rights and responsibilities by private negotiation. A commercial letter of credit, however, is a document which depends for its effectiveness upon the inducement it holds forth to third parties—to the beneficiary and to the negotiating bank or correspondent. Not until the precise nature of the engagement of the opening bank and its customer, each to the other, is universally established, can there be any certainty concerning the rights and responsibilities of these third parties. It was felt, therefore, that the adoption of standard forms of credit instruments must be preceded by the adoption of standard forms of appplication

and agreement to reimburse, if complete freedom from friction and misunderstanding was to be attained.

The Value of Precedent

So long as the phraseology of the forms of application and agreement to reimburse which were employed varied with each opening bank, it was impossible to arrive at a common interpretation of the mutual responsibilities of the parties. Such litigation as might arise between the opening bank and the accredited buyer would fix simply the meaning of the language employed in the particular writing before the court. On the other hand, now that standard forms are generally employed, their phraseology will quickly come to have a customary interpretation, and the decisions in any litigation which may ensue will serve as guide-posts for all.

The Value of a Common Policy

Of perhaps even greater value than the legal precedents which may be established, is the advantage which will result from the adoption of a common policy by opening banks with respect to the extent to which they will seek to protect the mercantile risk for the accredited buyer. Up to the present time some banks have perhaps gone too far, while others have fallen short, in the matter of requiring accredited buyers to relieve their correspondents and themselves from responsibility for the genuineness of the documents, the quality of the merchandise, and the performance by the seller of the terms of the contract of sale. The result has been that negotiating and paying banks have become involved in disputes and litigation, in some instances because of alleged lack of care in scrutinizing documents, although the same degree of scrutiny has in other cases been recognized as

fulfilment of their duty in that connection. Now that opening banks are a unit in dealing with accredited buyers on this point, the foundation is laid upon which to build a more consistent policy with respect to the protection of the mercantile risk, which will be considered in detail in Chapter XIV.

The Standard Application

The use of a standard form of application is calculated to assure the opening bank that it will receive at once all the information it requires, couched in language which is readily assimilated in commercial credit terminology. Such a form frees the bank from the precarious task of selecting the details to be incorporated in the credit from the mass of correspondence between buyer and seller which is otherwise usually tendered it with the request for the credit. The form of appplication adopted is shown in Figure 19.

The Agreement to Reimburse

It will serve as an interesting contrast to compare the rather extensive form which has now been devised to evidence the agreement of the accredited buyer to reimburse, with the brief form used to evidence a similar agreement with the National City Bank of New York, in connection with the credit shown in Figure 6 (page 47). This latter form was as follows:

The National City Bank of New York having, at our request, opened by today's mail a Revolving Credit with the Deutsche Bank (Berlin) London Agency, London, for Fifty Thousand Pounds Sterling (£50,000.-/-), available by the 90 d/s drafts of Messrs. Beeche & Co., Valparaiso, for payments to Cia Huanchaca de Bolivia, we hereby agree to cover the same National City Bank in due time for our drafts against this credit, plus a commission

Commercial Credit Conference

APPLICATION FOR COMMERCIAL LETTER OF CREDIT

.... (*opening bank*) .... *Date* ....

.... (*address*) ......

Dear Sirs:

I/We hereby request you to open and transmit by cable / mail an authority to pay / irrevocable letter of credit upon the following terms and conditions:

in favor of .... (*beneficiary*) ....

for account of .... (*applicant requesting credit*) ....

for a sum or sums not exceeding a total of .... (*amount in words*) ....

available by drafts on .... (if on applicant, without recourse)

at .... (*tenor of drafts*) ....

if accompanied by the following documents:

Full set of negotiable ocean bills of lading made out to the order of .... (*opening bank*) .... Bank.

Cross out documents not required.	Commercial invoice
	Consular invoice
	Marine insurance policy or certificate
	War risk insurance policy or certificate
	Certificate of ....
	Certificate of ....
	....
	....

evidencing shipment from ....

to .... of % .... / full invoice cost of .... (*name of property*) .... C.I.F. / F.A.S. / F.O.B. (*vessel*) .... (*place*) ......

Mine risk / Marine insurance to be effected by shipper / me/us under blanket policy No. .... issued by ...... (*name of insurance company*) ....

This credit is (not) to be confirmed by a correspondent bank.

Drafts must be drawn and presented, or negotiated, not later than .... (*expiration date*) ....

I/We hereby agree to sign, and deliver to you, an agreement for such credit, in the form now used by you, the provisions of which are agreed to as defining your rights and my/our obligations.

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is to be incorporated as part of the credit.

....

Figure 19. Standard Application for Commercial Letter of Credit

of $\frac{1}{8}$%, and we further agree to hold the National City Bank harmless in every way. (C.C. No. 93.) The credit to be confirmed from London by cable.

The difference between this simple agreement to reimburse the opening bank for payments made and the present standard form, adopted by the Commercial Credit Conference, can best be appreciated by examining the latter paragraph by paragraph and briefly setting forth the purpose each paragraph is intended to serve.

Commercial Letter of Credit Agreement

In consideration of your opening, at our request, your Commercial Letter of Credit No................, (herein called "the Credit") the terms of which appear on the reverse side hereof, and are hereby approved by us, we hereby agree as follows:

Specific approval of the terms of the credit is requested to prevent dispute as to whether the credit was opened in strict accordance with the terms of the application.

1. As to drafts or acceptances under or purporting to be under the Credit, which are payable in United States currency, we agree: (a) in the case of each sight draft, to reimburse you at your (New York) office, on demand, in United States gold coin, the amount paid on such draft or, if so demanded by you, to pay to you at your office in advance in such coin the amount required to pay such draft; and (b) in the case of each acceptance, to pay to you, at your (New York) office, in United States gold coin, the amount thereof, on demand but in any event not later than one business day prior to maturity, or, in case the acceptance is not payable at your (New York) office, then on demand but in any event in time to reach the place of payment in the course of the mails not later than one business day prior to maturity.

Agreement to reimburse the opening bank for payments made of dollar drafts.

2. As to drafts or acceptances under or purporting to be under the Credit, which are payable in currency other than United States currency, we agree: (a) in the case of each sight draft, to reimburse you, at your (New York) office, on demand, the equivalent of the amount paid, in United States gold coin at the rate of exchange then current in (New York) for cable transfers to the place of payment in the currency in which such draft is drawn; and (b) in the case of each acceptance, to furnish you, at your (New York) office, on demand, but in any event in time to reach the place of payment in the course of the mails not later than one business day prior to maturity, with first class bankers' demand bills of exchange to be approved by you for the amount of acceptance payable in the currency of the acceptance and bearing our endorsement, or, if you so request, to pay to you, at your (New York) office, on demand, the equivalent of the acceptance in United States gold coin at the rate of exchange then current in (New York) for cable transfers to the place of payment in the currency in which the acceptance is payable.

Agreement to reimburse the opening bank for payments made in foreign currency. Reimbursement for sight payments is required at the cable rate because payment has already been made at the time the opening bank and its customer are advised, and the further extension of credit in the form of a cash advance is not contemplated. Reimbursement for acceptances made is provided at the check rate, because there is time to forward checks before the acceptances mature. By requiring a check, the credit risk is shortened correspondingly, by the receipt by the opening bank of first-class bankers' bills of exchange several weeks in advance of the maturity of the acceptance. The opening bank has, however, the option of requiring a cable transfer, on demand, if it so desires.

3. We also agree to pay to you, on demand, a commission at the rate of............per cent (%) on such part of the Credit as may be used, and, in any event, a minimum commission of......

....per cent, of the amount of the Credit, and all charges and expenses paid or incurred by you in connection therewith, and interest where chargeable.

Brings the American practice into conformity with continental usage by charging a minimum commission to compensate the opening bank for the cost of opening the credit, though it be not utilized.

4. We hereby recognize and admit your ownership in and unqualified right to the possession and disposal of all property shipped under or pursuant to or in connection with the Credit or in any way relative thereto or to the drafts drawn thereunder, whether or not released to us on trust or bailee receipt, and also in and to all shipping documents, warehouse receipts, policies or certificates of insurance and other documents accompanying or relative to drafts drawn under the Credit, and in and to the proceeds of each and all the foregoing, until such time as all the obligations and liabilities of us or any of us to you at any time existing under or with reference to the Credit or this agreement or any other credit or any other obligation or liability to you have been fully paid and discharged, all as security for such obligations and liabilities; and that all or any of such property and documents, and the proceeds of any thereof, coming into the possession of your or any of your correspondents, may be held and disposed of by you as hereinafter provided; and the receipt by you, or any of your correspondents, at any time of other security, of whatsoever nature, including cash, shall not be deemed a waiver of any of your rights or powers herein recognized.

Intended to furnish a written recognition by the customer of the security title which the opening bank attains, according to the law of many of our states, by advancing the purchase price of the property which is the subject of the credit. Recognition of this security title is particularly valuable in asserting claim, in case of bankruptcy, in opposition to general creditors, against property which has been released in trust receipt.

5. Except insofar as instructions have been heretofore given by us in writing expressly to the contrary, we agree that you and any of your correspondents may receive and accept as "bills of lading" under the Credit, any documents issued or purporting to be issued by or on behalf of any carrier which acknowledge receipt of property for transportation, whatever the specific provisions of such documents, and that the date of each such document shall be deemed the date of shipment of the property mentioned therein; and that you may receive and accept as documents of insurance either insurance policies or insurance certificates.

Intended to prevent controversy by requiring the customer to indicate in advance his attitude toward the shipping and insurance questions which have been outlined in Chapter VIII.

6. Except insofar as instructions have been heretofore given by us in writing expressly to the contrary, we agree that part shipments may be made under the Credit and you may honor the relative drafts; and that if the Credit specifies shipments in instalments within stated periods, and the shipper fails to ship in any designated period, shipments of subsequent instalments may nevertheless be made in their respective designated periods and you may honor the relative drafts.

Requires the indication in advance of the customer's attitude toward further controversial matters.

7. We agree that in the event of any extension of the maturity or time for presentation of drafts, acceptances or documents, or any other modification of the terms of the Credit, at the request of any of us, with or without notification to the others, or in the event of any increase in the amount of the Credit at our request, this agreement shall be binding upon us with regard to the Credit so increased or otherwise modified, to drafts, documents and property covered thereby, and to any action taken by you or any of your correspondents in accordance with such extension, increase, or other modification.

Permits the modification of the terms of the credit at the request of the customer without notice to guar-

antors, but frees guarantors from any increase in amount in the request for which they did not join.

8. The users of the Credit shall be deemed our agents and we assume all risks of their acts or omissions. Neither you nor your correspondents shall be responsible: for the existence, character, quality, quantity, condition, packing, value, or delivery of the property purporting to be represented by documents; for any difference in character, quality, quantity, condition, or value of the property from that expressed in documents; for the validity, sufficiency, or genuineness of documents, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged; for the time, place, manner, or order in which shipment is made; for partial or incomplete shipment, or failure or omission to ship any or all of the property referred to in the Credit; for the character, adequacy, validity, or genuineness of any insurance; for the solvency or responsibility of any insurer, or for any other risk connected with insurance; for any deviation from instructions, delay, default, or fraud by the shipper or anyone else in connection with the property or the shipping thereof; for the solvency, responsibility or relationship to the property of any party issuing any documents in connection with the property; for delay in arrival or failure to arrive of either the property or any of the documents relating thereto; for delay in giving or failure to give notice of arrival or any other notice; for any breach of contract between the shippers or venders and ourselves or any of us; for failure of any draft to bear any reference or adequate reference to the Credit, or failure of documents to accompany any draft at negotiation, or failure of any person to note the amount of any draft on the reverse of the Credit or to surrender or take up the Credit or to send forward documents apart from drafts as required by the terms of the Credit each of which provisions, if contained in the credit itself it is agreed may be waived by you; or for errors, omissions, interruptions or delays in transmissions or delivery of any messages, by mail, cable, telegraph, wireless or otherwise, whether or not they be in cipher; nor shall you be responsible for an error, neglect, or default of any of your correspondents; and none of the above shall affect, impair, or prevent the vesting of any of your rights or powers hereunder. In furtherance and extension and not in limitation of

the specific provisions hereinbefore set forth, we agree that any action taken by you or by any correspondent of yours under or in connection with the Credit or the relative drafts, documents or property, if taken in good faith, shall be binding on us and shall not put you or your correspondent under any resulting liability to us; and we make like agreement as to any inaction or omission, unless in breach of good faith.

Intended to place the merchandise risk of the transaction on the customer, and not on the opening bank. It purposely frees the opening bank from responsibility and permits it to free any notifying, paying, confirming, or negotiating bank from responsibility, to an extent exceeding that they generally expect to be accorded. As we come, in Chapter XIV, to consider the protection of the mercantile risk, we shall see that it is highly desirable that the opening bank should possess latitude in this direction, so that it may be free to prevent its customers from raising some technical objection to the payment of drafts which have been negotiated in good faith. The paragraph gives effect to the opinion of the New York Supreme Court, Appellate Division, in the case of Lamborn v. The Lake Shore Banking and Trust Company (196 App. Div. 504), in which it was pointed out that the opening bank might rightfully insist upon a strict compliance by the beneficiary of the terms of the letter of credit, or waive strict compliance and nevertheless require the customer to reimburse it.

9. We agree to procure promptly any necessary import and export or other licenses for the import or export or shipping of the property and to comply with all foreign domestic governmental regulations in regard to the shipment of the property or the financing thereof, and to furnish such certificates in that respect as you may at any time require, and to keep the property adequately covered by insurance satisfactory to you, in companies satisfactory to you, and to assign the policies or certificates of insurance to

you, or to make the loss or adjustment, if any, payable to you, at your option; and to furnish you if demanded with evidence of acceptance by the insurers of such assignment.

Requires the customer to keep the property adequately insured.

10. Each of us agrees at any time and from time to time, on demand, to deliver, convey, transfer, or assign to you, as security for any and all of his and/or our obligations and liabilities hereunder, and also for any and all other obligations and liabilities, absolute or contingent, due or to become due, which are now or may at any time hereafter be owing by him or us to you, additional security of a value and character satisfactory to you, or to make such cash payment as you may require. Each of us agrees that all property belonging to him, or us, or in which he or we may have an interest, of every name and nature whatsoever, now or at any time hereafter delivered, conveyed, transferred, assigned, or paid to you, or coming into your possession or into the possession of anyone for you in any manner whatsoever, whether expressly as security for any of the obligations or liabilities of him or us to you, or for safekeeping or otherwise, including any items received for collections or transmission and the proceeds thereof, whether or not such property is in whole or in part released to us on trust or bailee receipt, are hereby made security for each and all such obligations and liabilities. Each of us agrees that upon his or our failure at all times to keep a margin of security with you satisfactory to you, or upon the making by him or us of any assignment for the benefit of creditors, or upon the filing of any voluntary or involuntary petition in bankruptcy by or against him or us, or upon any application for the appointment of a receiver of any of his or our property, or upon any act of bankruptcy or state of insolvency of him or us, all of such obligations and liabilities shall become and be immediately due and payable without demand or notice notwithstanding any credit or time allowed to him or us, or any instrument evidencing any such obligations or liabilities or otherwise; and each of us, as to property in which he may have any interest, and all of us, as to property in which we may have any interest, expressly authorize you in any such event, or upon his or our failure to pay any of such obligations or liabilities when

it or they shall become or be made due, to sell immediately, without demand for payment, without advertisement and without notice to us, or any of us, all of which are hereby expressly waived, any and all such property, arrived or to arrive, at private sale or at public auction or at brokers' board or otherwise, at your option, in such parcel or parcels and at such time or times and at such place or places and for such price or prices and upon such terms and conditions as you may deem proper, and to apply the net proceeds of such sale or sales, together with any balance of deposits and any sums credit by or due from you to him or us in general account or otherwise, to the payment of any and all of his and/or our obligations or liabilities to you however arising. If any such sale be at brokers' board or at public auction you may yourself be a purchaser at such sale, free from any right of redemption, which we and each of us hereby expressly waive and release.

Permits the opening bank to demand further security whenever it may seem desirable to require it, gives a lien against any property of the customer in the opening bank's possession, and provides for the immediate maturing of the obligation of any obligor who becomes insolvent, but not that of any other obligor who remains solvent.

11. You shall not be deemed to have waived any of your rights hereunder, unless you or your authorized agent shall have signed such waiver in writing. No such waiver, unless expressly as stated therein, shall be effective as to any transaction which occurs subsequent to the date of such waiver, nor as to any continuance of a breach after such waiver.

Intended to prevent disputes concerning alleged oral alterations of the agreement.

12. The word "property" as used in this agreement includes goods, merchandise, securities, funds, choses in action, and any and all other forms of property, whether real, personal or mixed and any right or interest therein.

A general definition of property.

13. If this agreement is signed by one individual, the terms "we," "our," "us," shall be read throughout as "I," "my," "me," as the case may be. If this agreement is signed by two or more parties, it shall be the joint and several agreement of such parties.

Yours very truly,

Credits Issued for Interior Banks

The rather limited powers given to our national and state banks by the provisions of the statutes under which they are created, result in the introduction into commercial credit business, undertaken in this country by one bank for account of another, of a problem from which foreign banking is free. Neither the provisions of the National Banking Act nor of the Federal Reserve Act, for instance, confer upon our national banks the power to guarantee or act as surety on a letter of credit. The result is that if the directors of a national bank enter into such a contract of guaranty or suretyship they assume in their personal capacity the risk of any loss that may occur. Yet it is only by some such agreement as this that an interior national bank, having no international standing, or without sufficient business to develop a department capable of handling foreign transactions, can take care of the needs of its customers who wish to obtain letters of credit which will be satisfactory to foreign dealers. If the customer himself must go to a large city bank where his financial standing may not be well known, his request for credit might be refused. On the other hand, the local bank, although it does not wish to, and cannot well, furnish a satisfactory letter of credit itself, may be quite willing to extend its credit to a seaboard bank which is equipped and has an international

standing sufficient to furnish a commercial credit satisfactory to the buyer.

This difficulty, arising because of the inability of a national bank to guarantee a letter of credit, may be avoided in several ways. The interior bank, instead of guaranteeing the letter of credit, can execute a separate instrument appointing its seaboard correspondent as its agent and agreeing, unconditionally, to reimburse it as such for any monies paid out in the case of a sight credit, or put it in funds to meet the acceptances as they mature in the case of a time credit. This procedure has been approved by the Federal Reserve Board and the Comptroller of the Currency in an opinion dated April 26, 1921. Another method which has perhaps the same effect is to have the application for the credit made directly by the interior bank to the seaboard bank with a simple undertaking on the part of the interior bank to place its agent in funds at maturity of drafts drawn thereunder, accompanied by a guaranty of similar tenor from the interior bank's customer to the seaboard bank.

CHAPTER XI

THE STANDARD COMMERCIAL LETTERS OF CREDIT

Export and Import Credits

The greatest difficulty encountered in drafting uniform commercial letters of credit was that of eradicating the idea that there was an inherent distinction between an export and an import credit. In their use of the terms "export" and "import," bankers and merchants generally lost sight of the fact that the terms do not relate to separate classes of transactions but only to the end from which a foreign shipment is viewed. Every foreign trade transaction is both an exportation and an importation; and every commercial credit is both an export and an import credit. To the beneficiary, who is the seller, and to the notifying, confirming, negotiating, or paying bank, it is an export credit; but to the accredited buyer and to the opening bank, it is an import credit.

There is, as we have seen, a difference between the circular negotiation type of credit, which was previously issued by London banks for our account, and which is now issued direct by American banks to finance our import transactions, and the specially advised, straight, dollar type of credit which our merchants demand as reimbursement for their export shipments. This, however, does not mean that one type is essentially of more value to the exporter or importer than the other. It indicates simply that an opening bank in good standing in a community, the financial stability of which is recog-

nized throughout the world and whose medium of exchange is everywhere in demand, can furnish a beneficiary a useful instrument of the negotiation type, while an opening bank in a vicinity which lacks these essential requirements must resort to the use of specially advised credits which instruct their correspondents to pay the beneficiary in his own currency.

The peculiarities of the American commercial credit business at the present time are due to these circumstances. The American importer cannot offer a safer or more useful credit in these days, when the dollar is everywhere in demand and the standing of American banks unquestioned, than the obligation of an American bank evidenced by the negotiation type of credit. By the same token, our exporters want, and feel that they are entitled to have, a similar obligation, not being content as a general thing to accept anything except a dollar credit confirmed by an American bank.

The Basic Idea

These considerations may be taken into account in fixing upon standard credit forms, but they cannot be made the basis of fundamental classification. The selection of a satisfactory type of credit, from the point of view of the beneficiary, depends primarily upon the purpose the beneficiary seeks to achieve. If he is entirely content to rely upon the buyer's promise to pay the drafts, and seeks only to avoid having his own capital or credit line utilized to finance the shipment while it is in transit, the authority to purchase will suffice. If he wants security against the credit risk, he will seek a form of credit which contains a banker's promise to pay. The particular type he selects will depend upon the degree of security he requires.

The basic idea behind the myriad forms of so-called authorities to purchase, authorities to pay, commercial and bankers', export, import, unconfirmed, confirmed, revocable, and irrevocable credits, is simple enough. They all evidence, in some fashion, either the obligation of the buyer or of his bank, or of his bank and a banking correspondent, located either in the domicile of the seller or elsewhere. So far as security is concerned, the adoption of three forms clearly evidencing these three types of obligation supplies all the variety that is needed. In fact, there has been no greater variety, from the standpoint of obligation; there has simply been uncertainty as to which combination of obligations is afforded in many of the credits that have been in vogue.

Selection of Obligation

As a basis for standardization, therefore, three types have been recognized by the Commercial Credit Conference as evidencing, respectively, the obligation of the buyer, but not of the opening or a notifying bank; the obligation of the opening, but not of a notifying bank; and the obligation of both the opening and the notifying banks.

The type of credit which evidences the obligation of the buyer, but not that of the opening or notifying bank to the seller, that his drafts will be paid is, as we have already seen, represented by the authority to purchase. In the work of standardization, the authority to purchase has been recognized as a useful type, because it fulfils the primary purpose of financing the shipment for account of the buyer. Its general employment is not recommended, however, primarily because its use is largely confined to the Far Eastern trade, where its nature is well understood, and secondly because the fact that recourse is

preserved against the beneficiary excludes it from the classification of bankers' credits.

A bankers' credit, in the American view, is not, as Mr. Spalding states, one in which the drafts are drawn on a bank, but rather a credit which constitutes a banker's engagement that drafts will be honored if drawn in accordance with its terms, though the terms stipulate that the buyer or another bank shall be the drawee.

Of bankers' credits, three types are recognized: if the engagement on the part of the opening bank that drafts will be honored is extended to the paying bank alone, it is termed an "authority to pay"; if to the beneficiary, it is termed an "irrevocable credit"; if the same engagement is also undertaken by a second bank, it is termed a "confirmed irrevocable credit."

Selection of Method of Transmission

For the transmission of the advice of authority to pay, only the specially advised straight payment form has been provided.

The authority to pay may be revoked or modified at the will of the opening bank, but this action cannot, in fairness, become effective against the paying bank, which is in effect the beneficiary, as against any drafts which it has prior to receipt of notice paid on the faith of the instrument. If the circular negotiation form were used by the opening bank for the issuance of the advice to the beneficiary, it would be impossible for the opening bank to notify every banker to whom the beneficiary might present it with his drafts for negotiation, of its revocation or modification, and the credit would become, in fact, irrevocable. Its very nature, therefore, restricts its use to the specially advised straight payment form.

For the transmission of the irrevocable type of credit,

two forms are provided—a specially advised form; and a circular negotiation form. The use of the specially advised form is essential in transmitting by cable the irrevocable type of credit, consisting of the obligation of the opening, but not of the notifying bank, and this form is convenient even when transmission is made by mail, for the notifying correspondent will have the facility that other bankers in the domicile of the beneficiary may lack, of verifying the signatures subscribed to the instructions. Furthermore, the use of the specially advised form enables the opening bank to build up its correspondent relationships, assures special attention to its own interests as well as to those of the beneficiary, and renders it possible subsequently to supplement or extend the credit terms with ease and safety.

Provision is made, however, for the transmission of the specially advised irrevocable credit form either as a straight payment or as a negotiation credit. The alternate methods are made available because it developed in the conference hearings that there was a diversity of opinion as to which method was preferable. One group of bankers contended that there was no occasion for a departure from past practice, in which there had generally been employed the straight payment type for credits providing payment in the beneficiary's local currency, and the negotiation type, which provided payment in foreign currency. Another group of bankers contended, on the other hand, that while the straight payment type was not suitable for foreign currency credits, because it restricted the freedom of negotiating for a satisfactory rate of exchange, the negotiation type was entirely suitable for both local currency and foreign currency credits. They felt that the sole adoption of the negotiation type would not only obviate the necessity of providing two methods for the

transmission of a practically identical obligation, but would increase the usefulness of the credit to a beneficiary whose office was not located in one of the financial centers where the credit-issuing banks are situated, by enabling him to cash his documents, even if in local currency, at his local bank. If this argument is sound, undoubtedly the specially advised negotiation credit will grow in use; otherwise the former practice of using the straight payment type for local currency credits will continue to be followed.

A circular form for the transmission of the irrevocable type of credit direct by the opening bank to the beneficiary is also provided, however, because long usage has demonstrated that the provision that the amounts negotiated must be indorsed on the back affords sufficient protection against double negotiation or other fraud, and because the form lends itself well to the negotiation type of credits.

For the sake of simplicity also only the specially advised form is employed in connection with the confirmed irrevocable type, consisting of the obligation of both the opening and the notifying bank. As it is not until confirmation has been given by the notifying bank that the effectiveness of this type is complete, there is no need of direct communication between the opening bank and the beneficiary, while the resort to a triangular correspondence might result in complications. It also is provided either as a straight payment or as a negotiation credit.

Advice of Authority to Pay—Commercial Credit Conference Form A

The advice of authority to pay, or Commercial Credit Conference Form A (Figure 20), has been termed the

COMMERCIAL CREDIT CONFERENCE—FORM A

ADVICE OF AUTHORITY TO PAY Advice No. A ....

.... (*city*) ....19...

....

....

Dear Sirs:

We advise you that ..... (*correspondent bank*) ...... Bank have authorized us to honor your drafts for account of ....for a sum or sums not exceeding a total of .... (*figures*) .... (*words*) on us at... to be accompanied by .... evidencing shipment of: .... insurance to be effected by ....

All drafts so drawn must be marked:

"Drawn as per ..... (*advising bank*) ..... Bank's Advice No. A ....., dated .... 19..."

Drafts so drawn, with documents as specified, must be presented at our office not later than .... 19 ...

The authority given to us is subject to revocation or modification at any time without notice to you.

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as part of this advice.

This advice conveys no engagement on our part or on the part of ...... (*correspondent bank*) ..... Bank and is simply for your guidance in preparing and presenting drafts and documents.

Yours very truly,

Figure 20. Authority to Pay—Commercial Credit Conference Form A

equivalent of the Far Eastern authority to purchase, but the two may differ in an important respect. The authority to purchase is not a bankers' credit, because, though the seller's drafts are negotiated for their face value by a bank for the buyer's account, there is no undertaking by a bank that they will be honored, but only by the buyer, who is the drawee of the drafts. For this reason the recourse against the seller as drawer of the drafts which the buyer's bank stipulates when it authorizes its branch or correspondent to advance the seller the face of the drafts, is vitally important. The process is simply one of making the buyer's discount line available to the seller. The authority to pay, on the other hand, permits the shipper to draw on the notifying bank, and the freedom from recourse after the draft is paid is then as effective as an engagement of the opening bank to the paying bank that the seller's draft will be paid. This freedom from recourse does not exist until his draft is presented and paid, but it is an effectual bar to further liability.

There is this similarity, between the two instruments, that the authority to pay, like the authority to purchase, gives the seller no protection against modification or cancellation. The authority to pay may be revoked or modified at any time without notice to the seller, who cannot, therefore, properly be termed the beneficiary. The American authority to pay is, in fact, identical with the English unconfirmed credit, which has been analyzed in detail in Chapter V (page 78). On the other hand, the authority to pay is not identical with the revocable credit —if that term is used with reference to a credit of which the seller is the beneficiary. A revocable credit is one which is good until revoked. It has been pointed out in Chapter IX, "The Right to Revoke," that the advantages which would accrue to the beneficiary by retaining

for him the right to have notice of revocation, are so slight in comparison with the difficulties and complications that would thereby be created, that it was thought advisable to recommend a form of credit which would emphasize the true aspect of the matter. For the "unconfirmed credit" therefore, which has puzzled Mr. Spalding and his associates, and for the "revocable" credit, about which American banks have disagreed, there is substituted the advice of authority to pay, which is equally useful and the nature of which is more precisely defined.

Irrevocable Credit

This type of credit evidences the irrevocable obligation of the opening bank to the shipper as beneficiary that his drafts will be honored. If it is transmitted through the medium of a notifying bank, the latter bank assumes no obligation other than to vouch for the authenticity of the information it transmits. Whether transmitted directly, or specially advised, it affords the beneficiary complete protection against cancellation. The two forms (see Figures 21 and 22) provided for the transmission of this type of credit are identical in legal effect.

Circular Type — Commercial Credit Conference Form B

The type of the irrevocable credit, represented by the Commercial Credit Conference Form B (Figure 21), is the classic circular negotiation form of credit which is preferably employed by banks with international reputations, where there is time for the instrument to reach the beneficiary by mail before he need use it. It can be employed either for local currency or foreign currency payments. If used as a local currency credit, it will

COMMERCIAL CREDIT CONFERENCE—FORM B

IRREVOCABLE CREDIT Credit No. B ....

.... (*city*).... .... 19...

....

....

Dear Sirs:

We hereby open our irrevocable credit in your favor for account of ....
for a sum or sums not exceeding a total of......... (*figures*)
.... (*words*)
available by your draft on ....
at ....
to be accompanied by ....
....
....
evidencing shipment of:
....
....
.... insurance to be effected by ....

All drafts so drawn must be marked:

"Drawn under .... (*issuing bank*) .... Bank
Credit No. B ....., Dated .... 19 ......"

(To be used when not all the documents are to accompany draft.)

There must be forwarded by early mail to ......Bank at ...., the following documents: .... All remaining documents must accompany the draft.

The amount of any draft drawn under this credit must, concurrently with negotiation, be endorsed on the reverse hereof; and the presentment of any such draft shall be a warranty by the negotiating bank that such endorsement has been made and that documents have been forwarded as herein required.

This credit must accompany any draft which exhausts the credit and must be surrendered concurrently with the payment of such draft.

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as part of this credit.

We hereby agree with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same shall be duly honored on due presentation, and delivery of documents as specified at .... if negotiated on or before .... 19....

Very truly yours,

Figure 21. Circular Type of Irrevocable Credit—Commercial Credit Conference Form B

stipulate that the beneficiary is to draw on a local correspondent of the opening bank, and presentation of the instrument by the beneficiary to the correspondent is sufficient authorization for it to debit the opening bank's account, though it is customary to send a separate advice of the opening of the credit to the correspondent. All in all, it is more simple to use the specially advised than the circular form for irrevocable local currency credits, though either may be utilized.

There is one departure from customary usage in connection with this standard circular form of irrevocable credit. It has been usual to require the negotiating bank to certify that at the time of its negotiation of a draft it has indorsed the amount on the reverse side of the credit instrument, and that the documents which do not accompany the draft have been forwarded as directed by the terms of the credit. The difficulty with this procedure has been that negotiating bankers have been careless about furnishing such certificates. When the certificate is lacking, the opening bank is placed in the dilemma of either offending the negotiating bank by refusing to honor the draft until the certificate is forthcoming, or of taking the risk which goes with the waiving of such omission. By providing in the present form of credit the statement that the presentment of a draft for honor shall be a warranty that these acts have been performed, the negotiating bank is protected from its failure to furnish a certificate, while the opening bank is relieved of the duty of making an unpleasant decision.

Specially Advised Type—Commercial Credit Conference Forms C-a and C-b

If the beneficiary is to be paid in his local currency, the most convenient way for the opening bank to arrange

to do so would be to instruct a correspondent in the domicile of the beneficiary to pay him local funds. As there is no question of a rate of exchange involved, so far as the beneficiary is concerned, it would be no hardship to him to make the credit available only at the office of this correspondent. It would have the advantage for the opening bank that the payment might be at once debited to the local currency account it maintained with the paying correspondent. Such a credit is supplied by Commercial Credit Conference Form C-a (Figure 22a). The difficulty with this plan is that beneficiaries are scattered throughout the country, while the opening bank cannot scatter its accounts in corresponding fashion. It must, for economical operation, concentrate its local currency accounts with the international banks in the large centers of foreign trade. The standard type, represented by the Commercial Credit Conference Form C-b (Figure 22b) is a departure from previous practice in this respect, that, while specially advised, it is in the negotiation and not the straight-payment form. It, therefore, enables the opening bank to provide payment of local currency out of a local currency account maintained with a banking correspondent in a trade center, and yet furnish the beneficiary an advice of which he may avail himself locally, or present his drafts directly to the notifying bank, as he prefers.

If the credit is to be issued and the drafts drawn in a foreign currency, the beneficiary is interested in having it advised to him in a fashion which will enable him to convert the foreign currency drafts into his local funds to his best advantage. If the beneficiary were required to present and surrender the documents at the office of the notifying correspondent, he would either have to accept payment in local currency at the exchange rate it quoted, or else demand its check in the foreign currency

COMMERCIAL CREDIT CONFERENCE—FORM C-a

CORRESPONDENT'S IRREVOCABLE STRAIGHT CREDIT

Advice No. C-a ......

.... (*city*) .... 19..

....

....

Dear Sirs:

We are instructed by ..... (*correspondent bank*) ...... Bank to advise you that they have opened their irrevocable credit in your favor for account of .... for a sum or sums not exceeding a total of .... (*figures*) .... (*words*) available by your drafts on us at........................ to be accompanied by .... evidencing shipment of: .... insurance to be effected by..........

All drafts so drawn must be marked:

"Drawn as per .... (*advising bank*) .... Bank's Advice No. C-a ....., Dated .... 19 ....."

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as a part of this advice.

.... (*correspondent bank*) .... Bank engages with you that all drafts drawn under and in compliance with the terms of this advice will be duly honored on delivery of documents as specified if presented at this office on or before .... 19 .....

This letter is solely an advice of credit opened by ...... (*correspondent bank*) .... Bank and conveys no engagement by us.

Very truly yours,

Figure 22. (a) Specially Advised Straight Irrevocable Credit—Commercial Credit Conference Form C-a

COMMERCIAL CREDIT CONFERENCE—FORM C-b

CORRESPONDENT'S IRREVOCABLE NEGOTIATION CREDIT
Advice No. C-b....

.... (*city*) .... 19 ..

....

....

Dear Sirs:

We are instructed by .... (*correspondent bank*) .... Bank to advise you that they have opened their irrevocable credit in your favor for account of........................ for a sum or sums not exceeding a total of .... (*figures*)
.... (*words*)
available by your drafts on ....
at............ to be accompanied by....................
evidencing shipment of:................................
.... insurance to be effected by ....

All drafts so drawn must be marked:

"Drawn as per .... (*advising bank*) .... Bank's Advice No. C-b .... Dated .... 19 ...."

(To be used when not all the documents are to accompany draft.)

There must be forwarded by early mail by the negotiating bank to ...... Bank, at ...... (*address*) ...... the following documents ....
All remaining documents must accompany the draft.

The presentment of each draft, if negotiated, shall be a warranty by the negotiating bank that documents have been forwarded as herein required, and that the amount of such draft has been endorsed on the reverse hereof; otherwise, this advice and all relative documents must accompany the draft.

This advice must accompany any draft which exhausts the credit and must be surrendered concurrently with the payment of such draft.

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as part of this advice.

.... (*correspondent bank*) .... Bank engages with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this advice that the same shall be duly honored on due presentation and delivery of documents as specified if negotiated, or presented at ...., on or before .... 19 ..

This letter is solely an advice of credit opened by .... (*correspondent bank*) .... Bank and conveys no engagement by us.

Very truly yours,

Figure 22. (b) Specially Advised Negotiation Irrevocable Credit—Commercial Credit Conference Form C-b

in which the draft is drawn. While he could sell the check elsewhere, he would nevertheless have to indorse it and thus assume an additional liability.

Whether the drafts be drawn in local or foreign currency, the type of credit represented by Commercial Credit Conference Form C-b permits the beneficiary to negotiate his drafts whenever he may choose, and if the notifying bank becomes the negotiating bank also, it is by voluntary agreement with the beneficiary.

Confirmed Irrevocable Credit—Commercial Credit Conference Forms D-a and D-b

The confirmed irrevocable credit, the standard forms of which are Commercial Credit Conference Forms D-a and D-b (Figures 23a and b), conveys exactly the same obligation on the part of the opening bank as does the irrevocable credit (Figures 21 and 22a and b), but in addition it carries the engagement of a confirming bank that the beneficiary's drafts will be honored. If the confirming bank is a local institution and the beneficiary is to be paid local currency by drawing drafts on it, then he has the undertaking of a bank which is close at hand that he will be paid at the proper time. If the confirming bank is an institution in some other place, on which the drafts are to be drawn for negotiation, its undertaking that they will be honored on presentation to it makes them more readily negotiable.

Regulations

While the adopted forms themselves represent in the main simply a refinement and adaptation of existing practices, the incorporation of regulations for their interpretation is a departure. So long as there is no uniform commercial practice with regard to certain questions which

COMMERCIAL CREDIT CONFERENCE—FORM D-a

CONFIRMED IRREVOCABLE STRAIGHT CREDIT

Credit No. D-a ....

.... (*city*) .... 19..

....

....

Dear Sirs:

We are instructed by .... (***correspondent bank***) ...... Bank to advise you that they have opened their irrevocable credit in your favor for account of ....
....
for a sum or sums not exceeding a total of........... (***figures***)
.... (***words***)
available by your drafts on us at.........................
to be accompanied by ....
....
evidencing shipment of:
....
....
.... insurance to be effected by ....

All drafts drawn under the credit must be marked:
"Drawn under ..... (***advising bank***) ..... Bank's
Credit No. D-a ......, Dated .... 19 ....."

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as a part of this credit.

...... (***correspondent bank***) ...... Bank engages with you that all drafts drawn under and in compliance with the terms of this credit will be duly honored on delivery of documents as specified if presented at this office on or before .... 19 ....; we confirm the credit and thereby undertake that drafts drawn and presented as above specified shall be duly honored by us.

Very truly yours,

Figure 23. (a) Specially Advised Straight Confirmed Irrevocable Credit—Commercial Credit Conference Form D-a

COMMERCIAL CREDIT CONFERENCE—FORM D-b

CONFIRMED IRREVOCABLE NEGOTIATION CREDIT

Credit No. D-b ....

.... (*city*) .... 19 ..

....

....

Dear Sirs:

We are instructed by .... (*correspondent bank*) .... Bank to advise you that they have opened their irrevocable credit in your favor for account of .... for a sum or sums not exceeding a total of .... (*figures*) .... (*words*) available by your drafts on .... at ....to be accompanied by.................. evidencing a shipment of .... insurance to be effected by ....

All drafts drawn under the credit must be marked:

"Drawn under .... (*advising bank*) .... Bank's Credit No. D-b ...., Dated .... 10 .."

(To be used when not all the documents are to accompany draft.)

There must be forwarded by early mail by the negotiating bank to .... Bank, at .... (*address*) ...., the following documents:.............................. All remaining documents must accompany the draft.

The presentment of each draft, if negotiated, shall be a warranty by the negotiating bank that documents have been forwarded as herein required, and that the amount of each draft has been endorsed on the reverse hereof; otherwise, this credit and all relative documents must accompany the draft.

This credit must accompany any draft which exhausts the credit and must be surrendered concurrently with the payment of such draft.

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as part of this credit.

.... (*correspondent bank*).... Bank engages with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this advice that the same shall be duly honored on due presentation and delivery of documents as specified, if negotiated, or presented at ...., on or before .... 19 ..; we confirm the credit and thereby undertake that drafts drawn and presented as above specified shall be duly honored.

Very truly yours,

Figure 23. (b) Specially Advised Negotiation Confirmed Irrevocable Credit—Commercial Credit Conference Form D-b

constantly arise in connection with commercial credit operations, it was considered advisable by the Commercial Credit Conference to continue the practice of indicating the interpretation that would be made in the absence of contrary instructions.

Standard Commercial Credit Regulations

A. (1) Railroad export and forwarders' bills of lading will not be accepted.

Foreign trade quotations and practices have grown up around the use of a contract of carriage issued by an ocean carrier as a basic shipping document. As the use of railroad export or forwarders' bills of lading does not conform to the general custom, their acceptance should be specifically authorized.

(2) Ocean bills of lading permitting transhipment will be accepted.

When the contract of sale is on a cost, insurance, and freight basis, the seller is entitled to select the route; where on a free-on-board basis the buyer has that right, but if he fails to exercise it by designating the route the seller becomes his agent for the purpose. So long as this selection is made with ordinary care, it is justified, even though it provides for transshipment.

B. (1) Bills of lading shall contain no words qualifying the acceptance of shipments in apparent good order and condition.

The insertion of rubber-stamped notations with reference to the condition of the merchandise or its container in bills of lading is made by the steamship company to afford a basis for a defense against claim for damage

during transit. If the use of the qualifying phrases is unwarranted, the shipper should insist upon their removal from the bill of lading and if their use is warranted it is apparent that an irregularity exists.

(2) "Received for shipment" or "alongside" bills of lading will be accepted and the date thereof taken to be the date of shipment, and in this case insurance shall cover the shipment from such date of shipment and on whatever vessels carried.

The use of this clause is necessitated by the present uncertainty, both as regards what constitutes a bill of lading and what constitutes shipment.

(3) When "on board" shipment is required and such shipment is represented by an "on board" bill of lading the bill-of-lading date will be taken as the date when such shipment was effected; if evidenced by "on board" endorsement, the endorsement date will be so taken.

The use of this clause is necessitated by the present uncertainty with regard to the interpretation of the term "shipment."

(4) Any extension of the date of shipment shall extend for an equal length of time the date for presentation or negotiation, and vice versa.

This clause is intended to cover the extension of the date of expiration of a credit which originally contained both an expiration date and a shipping date, when the amended instructions are silent with reference to the extension of the shipping date to correspond to the extended life of the credit itself.

C. The term "insurance" shall be construed as including underwriter's certificate of insurance.

This clause is necessitated by a recent English decision.

D. A shipment for any part of the specified property may be drawn against, if the pro rata value can be verified.

Intended to prevent misunderstanding with regard to partial shipment.

E. If shipment in installments within stated periods is specified, and there is a failure to ship in any designated period, shipments of subsequent installments, made in their respective designated periods, may be drawn against.

This provision is desirable in view of the conflict of laws in various jurisdictions with regard to instalment shipments.

F. When the indicated expiration date for presentation or negotiation falls upon a Sunday or legal holiday, the expiration is extended to the next succeeding business day.

This provision is desirable in view of the conflict of laws in various jurisdictions wth regard to the expiration of an obligation maturing on a Sunday or holiday.

G. Presentation must be made during the usual banking hours.

Intended to prevent an attempt on the part of a beneficiary to present documents on the expiration date at a time after the usual banking hours and after it is impossible to complete the banking operation involved.

H. The terms "prompt shipment," "shipment as soon as possible," "immediate shipment" or words of similar import shall be interpreted as requiring shipment to be effected within thirty days; and if no date for presentation or negotiation is stated such presentation or negotiation must be made within thirty days from the date of the credit or advice.

Intended to fix a workable rule with regard to the interpretation of what are otherwise controversial terms.

I. Documents representing more than the specified quantity of property may be accepted in the discretion of the paying or negotiating bank without thereby binding the buyer to accept or pay for such excesses but payment shall be limited to the sum named in the credit or advice.

In many classes of goods it is obviously impossible to deliver an exact quantity, and a credit which does not permit some latitude in this direction may unduly embarrass the beneficiary. On the other hand, the attempt to fix an arbitrary percentage of variation would invite an unscrupulous beneficiary to present the minimum quantity in the case of a rise in price and the maximum quantity in the case of a fall. The best solution of this problem appeared to be to permit the paying or negotiating bank to exercise its best judgment in the circumstances, thus giving it latitude to inquire into the custom of the trade and also to examine the terms of the contract of sale on that point, if it so desires.

J. The terms "approximately," "about," or words of similar import, shall be construed to permit a variation of not exceeding ten per centum from the named sum or quantity.

This clause is used to prevent controversy as to the maximum variation permitted by the use of the terms indicated.

K. Drafts drawn without recourse will not be honored.

The necessity for this clause is explained in Chapter XIII, "Recourse Against the Beneficiary."

L. Definitions of Export Quotations will be those adopted by the National Foreign Trade Council, Chamber of Commerce of the

U. S. A., National Association of Manufacturers, American Manufacturers' Export Association, Philadelphia Commercial Museum, American Exporters and Importers Association, Chamber of Commerce of the State of New York, New York Produce Exchange and the Merchants' Association of New York at a conference held in India House, New York, on December 16, 1919.

Intended to prevent disputes with regard to the interpretation of the terms usually employed in making export quotations.

While the use of regulations in connection with specially advised credits, of which American banks are the paying agents, has been in vogue since the adoption of the Regulations of 1920, there was considerable opposition on the part of the American bankers to a suggestion that regulations now be incorporated in the negotiation forms as well. Their opposition was based on the claim that the presence of regulations in circular negotiation credit instruments would make negotiating bankers reluctant to cash the beneficiaries' drafts. It would seem, however, to go without proving that a bank which negotiates drafts in connection with commercial credits would profit by knowing, at the time of negotiation, the interpretation that would be placed by the bank issuing the credit and its customer upon matters which are now the subject of dispute and litigation. It was the very absence of knowledge of the interpretation which American banks would put upon received-for-shipment bills of lading, resulting from the omission of any regulation on that point in American bankers' import credits, which caused Shanghai and Batavia bankers to cease negotiating drafts drawn thereunder in the autumn of 1920. The mere adoption of the standard forms will not result in the prevention of a recurrence of the wave of disputes that

arose in connection with this type of credit during the falling market of 1920, so long as recourse must still be had to litigation to determine the meaning of the phraseology employed. It is rather a reflection on the intelligence of bankers generally to assume that they would regard the presence of rules, which are intended to prevent the possibility of misunderstanding, as an obstacle to negotiation, and it is expected that the inclusion of the regulations will be regarded, in the long run, as more helpful than harmful.

CHAPTER XII

COMMERCIAL CREDIT ACCOUNTING

Value of the Accounting Viewpoint

We have seen that the commercial letter of credit derives its effectiveness from the fact that some party to it, in some fashion and at some time, assumes a liability, either to the beneficiary, or to bona fide holders of the beneficiary's drafts, or to both. The success of any attempt to improve commercial letter of credit forms must be measured by the extent to which the identity of these obligated parties, and the nature of their obligations, are thrown into clear relief. There is no better way to arrive at a conclusion concerning the extent to which the newly adopted standard forms have attained this end than to consider how bankers must handle them from the accounting viewpoint. If we can with ease determine the source and the exact nature of the liability which the bankers must show in their books of account, the objective has been attained. Let us therefore consider the standard forms, to see how the liability they evidence is to be set up.

Authority to Pay

The credit represented by the authority to pay is advised to the seller by the notifying bank on behalf of the opening bank without obligation on the part of either bank. At the time of advice the notifying bank need therefore set up no liability on its books, for it has undertaken no commitment. It is in fact the practice of

notifying banks not to set up any liability. Neither is the credit, until utilized, the actual commitment of the opening bank. However, it may become an actual liability of the opening bank to the notifying bank upon utilization by the beneficiary, and as this contingency may occur without its immediate knowledge, this liability in such case should from the outset be reflected in its books, as well as in those of the accredited buyer, as an actual liability. Whether any actual liability arises on the part of the opening bank to the notifying bank will depend upon the method of reimbursement.

1. Payment Type. When the beneficiary presents his draft to the notifying bank for payment, according to the terms of the authority, the situation of the parties is somewhat altered. If the opening bank maintains an account in local currency with the paying bank, and if the agreement between them so stipulates, the paying bank upon cashing the beneficiary's draft reimburses itself by debiting the account. The commitment of the buyer is then converted into an actual liability to the opening bank to reimburse it for the payment it has made through its correspondent. The neutral position of the paying bank is unchanged, as it has not paid out its own funds.

2. Reimbursement Type. However, it may be that the opening bank does not maintain a local currency account with the paying bank; or, if it does, it may be that it prefers not to have the account charged. To see why a bank may have any preference in this matter, let us consider a London bank which is opening a credit in New York at a time when the trend of exchange between these centers is against London. If a debit is made at the time of shipment by the New York bank to the dollar account of the London bank, the obligation of the English buyer will be to replace those dollars. This

he will do by covering them in sterling at the London cable rate on New York current on the day of receipt of mail advice in London of the debit which has been made in New York, plus interest for the time the mail advice has been in transit. If, however, the New York bank, instead of debiting the London bank's dollar account, is content to advance the funds, it can give the buyer the benefit, in an exchange market which is running against him, of an earlier conversion. The New York bank will immediately convert the dollar payment into sterling at the New York bank's selling rate on that date for checks on London. It then debits its own sterling account with the equivalent of the dollars paid out and draws on the opening bank for that amount through the London bank in which its sterling account is maintained.

When there is such an arrangement, the issuance of the authority to pay creates a contingent liability on the part of the opening bank to reimburse the paying bank for its outlay. No actual liability need, theoretically, be set up on the books of the opening bank until the day the notifying bank makes the payment. Until then it could be shown as a contingent liability, except for the practical difficulty that both here and in the case of the liability of the buyer to reimburse the opening bank in turn, it becomes an actual liability without their knowledge. It is prudent, therefore, as it is usual, to show it as an actual liability from the outset.

Inter-Bank Form A—Authority to Pay

To set forth and define with exactitude the relationship created between the opening bank and the notifying bank in connection with the issuance of an advice of authority to pay, the Commercial Credit Conference has recommended the use of the form shown in Figure 24

COMMERCIAL CREDIT CONFERENCE—INTER-BANK FORM A

AUTHORITY TO PAY   Authority No. A ......

..... (*correspondent bank*) ...., ...19....

.... (*city*) ....

Dear Sirs:

We request you to advise .... (*name*) .... (*address*) .... (*city*) .... (*state*) .... that we have authorized you to honor their drafts for account of ....

....

for a sum or sums not exceeding a total of .... (*figures*) .... (*words*) on you at.. to be accompanied by ....

....

....

evidencing shipment of:

....

.... insurance to be effected by ....

This authority is valid for drafts so drawn, with documents as specified, presented at your office not later than .... 19 ......, unless it is previously revoked or modified by receipt by you of notice from us to that effect.

For your reimbursement you may:

(Put cross in square opposite method desired)
- ☐ Debit our account with you.
- ☐ Draw on us at ....

This authority is to be advised to the beneficiary by you on Commercial Credit Conference Form A.

Yours very truly,

Figure 24. Commercial Credit Conference—Inter-bank Form A (Authority to Pay—Advice from Opening Bank to Paying Bank)

and entitled "Commercial Credit Conference—Inter-bank Form A."

Inter-Bank Forms C-a and C-b—Irrevocable Credit

Let us now consider whether the liability of the various parties is altered by the use of the irrevocable credit. Such a credit is a contingent obligation of the opening bank to the beneficiary from the date of issuance until the date of expiration or exhaustion. Practically, as the date of conversion from contingent to actual liability, which may occur when it is utilized by the beneficiary, is uncertain, such a credit is carried as an actual liability of the opening bank and of the accredited buyer from the outset.

1. Negotiation Type. If the credit is issued in the circular negotiation form, or Commercial Credit Conference Form B (Figure 21), stipulating that the drafts are to be drawn in a foreign currency, the situation of a negotiating bank and of the opening bank and the accredited buyer are, after negotiation, in every respect identical with that which exists in any kind of reimbursement credit, after payment. There is an actual liability on the part of the opening bank to honor the negotiated draft, and on the part of the accredited buyer to furnish it the necessary funds. And while this liability only becomes actual as drafts are negotiated, it is prudent and customary as a practical matter to consider the liability as actual from the outset, as it may in fact become converted from a contingent to an actual liability without the knowledge of the obligors.

2. Specially Advised Type. As the negotiating bank enters into the transaction voluntarily, on the strength of the credit instrument, there is no occasion for an inter-bank form in connection with the negotiation type

of the irrevocable credit. However, if the specially advised form as shown in Commercial Credit Conference Forms C-a and C-b (Figures 22a and 22b) is utilized, there is need for an inter-bank communication for which Commercial Credit Conference Inter-Bank Forms C-a and C-b (Figures 25a and 25b) is recommended.

The notifying bank, if the specially advised form of irrevocable credit is used, carries the same neutral relation to it at the time of issuance as to the advice of authority to pay. Similarly, if local currency drafts are paid by it to the debit of the opening bank's account, its position remains neutral; while, if it draws in reimbursement or negotiates drafts in foreign currency, the opening bank comes under an obligation to it as well as to the beneficiary.

Inter-Bank Forms D-a and D-b—Confirmed Irrevocable Credit

If the confirmed irrevocable credit (Commercial Credit Conference Forms D-a and D-b) (Figures 23a and 23b) is employed, this type, from the accounting standpoint, simply adds to the irrevocable credit the contingent obligation of the confirming bank to the beneficiary, from the date of issuance until the date of expiration or exhaustion. If the drafts drawn in connection with a confirmed irrevocable credit are sight drafts, to be debited to the account of the opening bank by the confirming bank, the liability of the opening to the confirming bank is at once terminated by payment, and that of the accredited buyer to the opening bank is the same as in the authority to pay. In the event of failure to pay, the beneficiary's remedy is against the confirming bank as well as the opening bank. The form of inter-bank agreement recommended for use in this

COMMERCIAL CREDIT CONFERENCE—INTER-BANK FORM C-a

IRREVOCABLE STRAIGHT CREDIT

Credit No. C-a . . . .

. . . . , ... 19. . . .

. . . . . (*correspondent bank*) . . . . .

. . . . (*city*) . . . .

Dear Sirs:

We request you to advise . . . . (*name*) . . . . (*address*) . . . . (*city*) . . . . (*state*) . . . . that we have opened our irrevocable credit in their favor for account of . . . . for a sum or sums not exceeding a total of . . . . (*figures*) . . . . (*words*) available by their drafts on you at . . . . to be accompanied by . . . . evidencing shipment of: . . . . insurance to be effected by . . . .

We engage with the beneficiary that all drafts drawn under and in compliance with the terms of the advice will be duly honored on delivery of documents as specified if presented at your office on or before . . . . 19 . . . . .

For your reimbursement you may:

(Put cross in square opposite method desired)

☐ Debit our account with you.

☐ Draw on us at . . . .

This credit is to be advised to the beneficiary by you on Commercial Credit Conference Form C-a.

Yours very truly,

Figure 25. (a) Commercial Credit Conference—Inter-bank Form C-a (Specially Advised Straight Irrevocable Credit—Advice from the Opening Bank to the Notifying Bank)

COMMERCIAL CREDIT CONFERENCE—INTER-BANK FORM C-b

IRREVOCABLE NEGOTIATION CREDIT

Credit No. C-b ....

........, ... 19 ....

.... (*correspondent bank*) ....

.... (*city*) ....

Dear Sirs:

We request you to advise........ (*name*) .... (*address*) .... (*city*) .... (*state*) .... that we have opened our irrevocable credit in their favor for account of .... for a sum or sums not exceeding a total of .... (*figures*) .... (*words*) available by their drafts on.........(if on accredited buyer, without recourse) at .... to be accompanied by .... evidencing shipment of

....

.... insurance to be effected by ....

{ To be used when not all the documents are to accompany draft.

There must be forwarded by early mail by the negotiating bank to .... at ...., the following documents .... All remaining documents must accompany the draft. }

We engage with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of the advice that the same shall be duly honored on due presentation and delivery of documents as specified, if negotiated or presented at .... on or before .... 19 ....

If the terms of the advice authorize the beneficiary to draw on you, for your reimbursement, you may:

(Put cross in square opposite method desired)

☐ Debit our account with you.

☐ Draw on us at ....

This credit is to be advised to the beneficiary by you on Commercial Credit Conference Form C-b.

Yours very truly,

Figure 25. (b) Commercial Credit Conference—Inter-bank Form C-b (Specially Advised Negotiation Irrevocable Credit—Advice from the Opening Bank to the Notifying Bank)

connection is the Commercial Credit Conference Inter-Bank Forms D-a and D-b (Figures 26a and 26b).

Acceptance Credit

If the drafts are drawn, at time, for acceptance, the situation is somewhat altered. If they are drawn on a confirming bank, by accepting them the bank becomes primarily liable to bona fide holders for payment of them at maturity; if the drafts are drawn directly on the opening bank, by accepting them it assumes the same liability as the confirming bank in the first case.

This brings us to an interesting question. Has the accepting bank, by actually accepting the drafts which, as the opening or confirming bank, it had already legally committed itself to accept, altered its liability in any fashion? The Federal Reserve Board, by a ruling of its law department, which appears in the *Federal Reserve Bulletin* of July, 1921, differentiated these liabilities thus:

> A member bank may issue a letter of credit by which it agrees within a specified time, which may be more than six months, to accept drafts aggregating certain amounts, although each individual draft drawn under the credit must not have a maturity of more than six months. Similarly, it would seem that a member bank may issue a letter of credit, the aggregate amount of which may be in excess of the 50 per cent or 100 per cent of the bank's capital and surplus, provided that the aggregate amount of the acceptances made under the letter of credit and outstanding at any one time does not exceed, in addition to the bank's other outstanding acceptances, the aggregate limitation upon acceptances prescribed in section 13.

Since the acceptance liability is of a different nature from that assumed by the agreement to accept, it must be set up in some other way. It is customary to reflect it by debiting the amount of each acceptance, as made,

Commercial Credit Conference—Inter-bank Form D-a

CONFIRMED IRREVOCABLE STRAIGHT CREDIT

Credit No. D-a ....

........, ... 19 ....

..... (*correspondent bank*) .....

.... (*city*) ....

Dear Sirs:

We request you to advise .... (*name*) ....
.... (*address*) .... (*city*) .... (*state*) ....
that we have opened our irrevocable credit in their favor for account of:

....

for a sum or sums not exceeding a total of .... (*figures*)
.... (*words*)
available by their drafts on you at......................
to be accompanied by ....
....
evidencing shipment of:
....
.... insurance to be effected by ....

We engage with the beneficiary that all drafts drawn under and in compliance with the terms of the credit will be duly honored on delivery of documents as specified if presented at your office on or before .... 19 ....; we authorize you to confirm the credit and thereby to undertake that drafts drawn and presented as above specified shall be duly honored by you.

For your reimbursement you may:

(Put cross in square opposite method desired) ☐ Debit our account with you.
☐ Draw on us at ....

This credit is to be advised to the beneficiary by you on Commercial Credit Conference Form D-a.

Yours very truly,

Figure 26. (a) Commercial Credit Conference—Inter-bank Form D-a (Specially Advised Straight Confirmed Irrevocable Credit—Advice from Opening to Confirming Bank)

COMMERCIAL CREDIT CONFERENCE—INTER-BANK FORM D-b

CONFIRMED IRREVOCABLE NEGOTIATION CREDIT

Credit No. D-b ....

..........., ... 19....

.... (*correspondent bank*) .....

........(*City*)..........

Dear Sirs:

We request you to advise........ (*name*)........ .... (*address*) .... (*city*) .... (*state*) .... that we have opened our irrevocable credit in their favor for account of:

....

for a sum or sums not exceeding a total of .... (*figures*) .... (*words*) available by their drafts on ....(if on accredited buyer, without recourse) at.................................... to be accompanied by ....

evidencing shipment of:

....

.... insurance to be effected by ....

To be used when not all the documents are to accompany the draft.

There must be forwarded by early mail by the negotiating bank to .... at........, the following documents .... All remaining documents must accompany the draft.

We engage with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of the credit that the same shall be duly honored on due presentation and delivery of documents as specified ....if negotiated or presented at .... on or before .... 19..; we authorize you to confirm the credit and thereby to undertake that drafts drawn and presented as above specified shall be duly honored. If the terms of the credit authorize the beneficiary to draw on you, for your reimbursement you may:

(Put cross in square opposite method desired)

☐ Debit our account with you.
☐ Draw on us at ....

This credit is to be advised to the beneficiary by you on Commercial Credit Conference Form D-b.

Yours very truly,

Figure 26. (b) Commercial Credit Conference—Inter-bank Form D-b (Specially Advised Negotiation Confirmed Irrevocable Credit—Advice from Opening Bank to Confirming Bank)

to an account bearing some title as "Our Acceptances under Commercial Credits." If the accepting bank is other than the opening bank, the opening bank, at the same time, assumes an actual liability to put the accepting bank in funds to pay the drafts at maturity. This liability is shown on the asset side of the accepting bank's statement under some such title as "Customers' Liability under Commercial Credits." The opening bank's liability to the accepting bank is carried on the liability side of its ledger under some such caption as "Acceptances of Foreign Correspondents under Commercial Credits," and is offset by an item on the asset side under some such title as "Customers' Liability under Commercial Credits." This latter account reflects the liability of the accredited buyer to the opening bank, which the buyer must in turn show as a liability on his books.

Anticipated Payment

Delivery of the documents in connection with an acceptance credit is made by the opening bank to an accredited buyer whose standing is not beyond question, only against payment. If the buyer has resold the goods and obligated himself to deliver them prior to the date at which the acceptance matures, he will find it necessary, in order to get possession of the goods, to make immediate payment of the funds which he has agreed to put into the hands of the opening bank at maturity.

If for this, or any other reason, the accredited buyer pays in the funds to liquidate acceptances in advance of this maturity, are the funds so paid in to be regarded simply as a deposit? They might, for instance, be treated as a time deposit of a duration equivalent to the period the acceptances had still to run, on which interest might be credited at the rate permitted on similar time deposits.

It is more logical, however, to receive the money as in full or part payment of the customer's obligation to put the bank in funds at the maturity of the acceptance. If the money is received on this understanding, solely to be applied in payment of the acceptance at maturity, it is obvious that the customer's liability may be taken from his books and that the opening bank must wipe out its corresponding entry in the account, "Customers' Liability under Commercial Credits." If the opening bank has not made the acceptance, and it in turn remits the money to the accepting bank, that bank must also extinguish the corresponding item it has carried under "Customers' Liability under Commercial Credits." It is because of such operations as this that the item, "Customers' Liability under Commercial Credits," often appears on bank statements at a figure somewhat below the outstanding acceptances.

Rebate Interest

The accredited buyer who has placed funds in the hands of his bank prior to the date on which the bank is under obligation to dispose of them, is, of course, entitled to earn interest on the funds thus placed at the bank's use. If the bank could locate the holder of the acceptance in question, and he were prepared to sell it, the bank could buy it at the current rate and cancel it. Practically the same result could be obtained by purchasing any other of its outstanding acceptances. It is not often perhaps that the accepting bank actually applies the specific deposit to that purpose, but it is the possibility of doing so which fixes the rate. The rebate is consequently calculated at ½ per cent below the selling rate for the bank's acceptances of corresponding maturity. The ½ per cent compensates the bank for the trouble to which it is put in reinvesting its funds.

CHAPTER XIII

RECOURSE AGAINST THE BENEFICIARY

A Popular Misunderstanding

Sooner or later it occurs to every merchant who draws drafts in availing himself of a commercial letter of credit, to inquire what recourse, if any, exists against him as drawer. Sometimes he directs his question to a fellow-merchant; usually he interrogates his bank; occasionally he seeks the advice of counsel. The author of this book calls many merchants friend, and is himself both banker and lawyer; he finds it, therefore, undiplomatic to indicate which source of information is most likely to produce the correct answer. But whether it results from a paucity, or too great a number of counsellors, there is great confusion in the minds of merchants on this question. There is current an impression that one of the virtues of a confirmed credit is that the drafts which are drawn against it are without recourse. There is an equally well-fixed belief that one of the weaknesses of an unconfirmed credit is that drafts are drawn with recourse. The term "recourse" is used by those who hold these views to designate a situation in which the beneficiary remains liable to refund the amount advanced him, with interest, until the ultimate liquidation by the buyer of his obligation to the issuing bank.

The only real importance about the subject of recourse arises from the fact that neither of these prevalent impressions is true. Recourse may exist against the drawer of a draft in connection with a confirmed credit, and quite

as frequently recourse does not exist in connection with an unconfirmed credit. And where recourse exists it is usually of a quite different character from that just described and is not often of practical moment.

How Recourse Is Determined

We shall be baffled at the outset, in running down this question of recourse, to find that most letters of credit are discreetly silent on the subject and give no clue by which it may be traced. By searching a while, we may, with luck, find a commercial letter of credit which specifically states that drafts may be drawn without recourse. That information is comforting to the anxious beneficiary, but will not quiet the earnest seeker after truth. After more research, he may chance upon a commercial letter of credit which recites, in language similar to that employed in an authority to purchase, that recourse is retained. The usual phrase reads "this advice. . . . does not relieve you from the ordinary liability attaching to the drawer of a bill of exchange." Now we have the scent! What ordinary liability attaches to the drawer of a bill of exchange? The Uniform Negotiable Instruments Law provides that the drawer of a bill of exchange, by drawing it "engages that on due presentment the instrument will be accepted and paid, or both, according to its tenor, and that if it be dishonored, and the necessary proceedings of dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent endorser who may be compelled to pay it." (Section 111, New York Negotiable Instruments Law.)

In brief, the drawer of a draft must pay, if the drawee does not. To test this question of recourse, then, as applied to a commercial letter of credit, we must isolate the draft from its surroundings, and contemplate the

rights and liabilities of the parties to it as to any other bill of exchange. Having this in mind, let us examine the various types of credits which are offered to American exporters, to ascertain on whom the beneficiary must draw, and at what terms.

Dollar Sight Credits

The shortest possible route between the drawing of the draft and its presentment to the drawee is the quickest way out of liability to recourse. To the beneficiary of a credit which stipulates that drafts are to be drawn in his local currency, on a paying bank around the corner, recourse is a feeble thing, which "dies a'borning." His draft is drawn at his office, or perhaps at the counter of the bank, and in return for the surrender of the draft to the bank on which it is drawn, he receives its check for the face amount of the draft. The draft is thereby paid and extinguished, and the beneficiary's liability as drawer is terminated. In fact, the tender of a draft in connection with this type of credit is a pure formality which the paying bank will waive. It serves only as a receipt and as an indication of the payee designated to receive the money due to the beneficiary. A letter will suit both these purposes equally well.

Unconfirmed Sight Credits

Now that we know how recourse is created and extinguished, let us apply our newly acquired knowledge to the idea that recourse is inseparably associated with unconfirmed credits. An unconfirmed credit, we have learned, is one of which the beneficiary has been advised through the medium of a notifying bank, which acts simply as a medium for the transmittal of information from the opening bank. Such a credit may be either

revocable or irrevocable on the part of the opening bank. It may stipulate that the drafts are to be drawn in local currency on the notifying bank, which in that case is also to assume the rôle of paying bank; it may require drafts in foreign currency on the opening bank or on the accredited buyer and contemplate that some local bank will volunteer for the rôle of negotiating bank.

However, the type of unconfirmed credit which has been in most familiar use in the United States, and on which over half of our export commercial credit business has been done, is the revocable type which is availed of by drawing a draft in dollars at sight on an American bank. In May, 1921, merchants interested in the development of our foreign trade met at the Chamber of Commerce of the State of New York and declared this type of credit "useless for the security desired and not considered of any value for import or export transactions." The American bank does not undertake in advance that drafts will be paid, it is true; the credit does not therefore offer protection against cancellation prior to its utilization, and to that extent does not give "the security desired." But if on presentation the draft is paid, the beneficiary is out of the transaction from that point. He is not concerned whether the bank which paid him the money is reimbursed by the opening bank, or whether the opening bank is in turn reimbursed by the accredited buyer. Such a credit, therefore, fulfils the primary function of the commercial credit device in financing the shipment, and also serves the secondary purpose of safeguarding the credit risk during the period of transit. Though it fails to protect the beneficiary against loss caused by its cancellation prior to the time shipment has been effected, the documents have been presented, and the draft has been paid, it is far from "useless as security."

Confirmed Sight Credits

The type most popular to the American exporter has been the irrevocable credit, confirmed by an American bank and availed of by drafts drawn on it at sight in dollars. By confirming the credit the American bank undertakes that the drafts will be honored. It thus affords protection against cancellation of the credit prior to utilization. In every other respect it is like the revocable credit. So far as recourse is concerned, it does not exist against the drawer in either the confirmed or unconfirmed type of sight dollar credits just described, because the drafts are drawn at sight on the paying bank. What about time drafts on the paying bank?

Dollar Acceptance Credits

Undoubtedly the most useful form of commercial credit for American trade at the present time, of which we shall say more in the proper place, is the dollar acceptance credit. The difference between it and the forms of sight credits just set forth is that the drafts are drawn at time and not at sight. On first presentation to the notifying or confirming American bank they are not paid, but accepted. The acceptance is evidenced by a notation to that effect written on the face of the draft, with the date of acceptance, subscribed in the name of the bank (Figure 27).

The accepted draft is at the disposal of the drawer. If he is not in need of money he can hold it until maturity and present it for payment. If he needs funds he can readily dispose of it at the preferential rate which bank paper commands, either to a bank or to one of the discount houses which have built up a ready market in this country for that class of paper.

But what about recourse? It is the name of the

acceptor, not of the drawer, which gives a bank acceptance a ready market. In advertising for sale the bills in their portfolios, discount houses list only the names of

$10,000.— New York, *Jan. 18,* 19*22*

Ninety (90) Days after *sight* pay to the order of

ourselves

Ten thousand only Dollars

Value received and charge to account of letter of credit N. C. B. No. *5000*

To the National City Bank of New York
New York City

American Export Co.

ACCEPTED
Jan. 18, 1922
The National City Bank of New York
New York
By
Vice President

Figure 27. Bank Acceptance

the acceptors. The buyer rarely seeks to know the name of the drawer before making his purchase of a bank acceptance. Nevertheless, we need only to reread the provisions of the Negotiable Instruments Law already quoted, to appreciate that the drawer is liable to a bona fide holder if the drawee fails to pay the draft at maturity.

Nature of Recourse

Recourse in this case, however, is not the sort the beneficiary usually has in mind. There is nothing in it which makes the beneficiary liable to refund the amount advanced him, with interest, until the ultimate liquidation by the accredited buyer of his obligation to the issuing bank, or that of the issuing bank to the accepting bank. The risk the beneficiary runs as drawer of a draft drawn on and acccepted by a bank is simply that of the solvency of that bank. The only recourse that exists is terminated by the payment the accepting bank makes of the draft at maturity when presented by the bona fide holder.

Oftentimes the drawer would not suffer because of this right of recourse, even though the accepting bank had failed. In the form which is employed, for instance, by American banks for sterling acceptance credits, the American bank issues an instrument by which it undertakes that the beneficiary's drafts will meet with due honor on presentation to its London correspondent. Consequently, if the London bank failed after acceptance and was unable duly to honor its acceptance at maturity, the beneficiary, though he would have to reimburse a bona fide holder, could recoup himself from the American issuing bank. The new uniform credits are drawn in a form which gives the beneficiary this protection.

It is an interesting speculation, which has apparently never come up either for decision or discussion, as to whether the accredited buyer in this instance would be under the duty to recoup the beneficiary if the opening bank were also insolvent. It might be argued that as the seller had elected to rely on the credit of the now insolvent bank rather than on that of the buyer, he must stand by his choice. This argument, however, overlooks the fact that the use of the acceptance, instead of a sight credit, is primarily for the benefit of the buyer. Moreover, the history of the development of commercial credits indicates that they have tended, as in the matter of confirmation, for instance, toward the idea of superimposing one obligation on another. It would seem in keeping with the general tendency, therefore, to expect the accredited buyer to be held liable in such a case.

Drawing for Acceptance Without Recourse

Section 111 of the New York Negotiable Instruments Law, which has just been quoted, contains this further provision: "but the drawer may insert in the instrument

an express stipulation negativing or limiting his own liability to the holder." If the liability of the drawer of a bank acceptance is unimportant, the question naturally arises as to whether the drawer might not obviate the necessity of carrying the remote contingent liability on his books by adding to his signature the phrase, "Drawn without recourse." The accepting bank could have no objection to such a procedure, as in no event could it look to the drawer for recourse in case it is not otherwise reimbursed.

The practical difficulty is, however, that a draft drawn in that fashion is thereby rendered ineligible for rediscount by a federal reserve bank, which impairs its salability. The Federal Reserve Board has ruled that drafts so drawn are not eligible for discount by federal reserve banks or for purchase by them in the open market. The reason for this ruling is thus explained by E. R. Kenzel, Deputy Governor of the Federal Reserve Board of New York:

> Under section four of the law, what the Federal Reserve Bank may purchase, is regulated. Very great distinction was made between bills of exchange and promissory notes. When one name on a bill of exchange is eliminated, the resulting instrument is nothing more than a promissory note, and promissory notes are not lawfully purchased by the Federal Reserve Banks.

The practical motive which underlies this technical ruling is doubtless the feeling that a merchant who is willing to assist in the creation of a credit instrument, which is eligible to become part of the resources of our federal reserve banks and security for their note issues, should sufficiently satisfy himself of the responsibility of the accepting bank to be content to become liable if the bank fails. However, as this liability, though existent,

is unimportant, we must look further if we are to find a practical reason for concern about the question of recourse.

Foreign Currency Credits

In issuing the negotiation type of credit, it will be remembered, the issuing bank does not specifically instruct a correspondent to pay the beneficiary. It relies rather on the belief that bankers in the domicile of the beneficiary will be induced to negotiate drafts drawn by the beneficiary on the issuing bank, on the strength of the undertaking that they will be honored when presented overseas. Here again, as in the case of the purchase of a bank acceptance, the negotiating bank relies upon the name of the bank which has undertaken to accept. But again the Negotiable Instruments Law undoubtedly preserves the drawer's liability, unless he is permitted to evade it by drawing without recourse. The practical objection to such a procedure is that it causes the bill to be regarded with suspicion and impairs its salability.

Neither is this recourse of the sort which makes the beneficiary liable in case the buyer fails to liquidate the transaction. The beneficiary's liability as drawer in this case is, like his liability on an accepted draft, contingent upon the solvency of the bank, which in this case, instead of already having accepted the draft, has agreed in advance in writing, to duly honor it on presentation. The beneficiary of such a credit should satisfy himself at the time he receives it that it contains the engagement of a responsible bank that his drafts, drawn in accordance with its terms, will be honored. If he is not satisfied with that engagement, the credit is "useless for the security desired." If he is satisfied, the credit gives him protection though his drafts are drawn and negotiated with recourse. We have

not yet, therefore, reached the point where recourse becomes of practical importance.

The Real Question

The rule to be deduced from what has been said above on the subject is that recourse exists against the beneficiary in favor of any bona fide holder, in connection with any draft he draws to avail himself of a commercial credit. Where he escapes, it is because the terms of the credit enable him to draw a draft which he can himself present to the drawee for payment instead of getting his funds by negotiating it to a bona fide holder. But this recourse arises only in the event that the drawee fails to honor the draft, and a banker's credit is an undertaking, by a bank, in legal form, that it will be honored!

The real question is: Has a reliable bank undertaken at some time and at some place to honor the draft? If that undertaking is satisfactory, recourse is of academic interest. It becomes of importance only when there is no satisfactory undertaking that the draft will be paid. To find such a credit we must go beyond the scope of bankers' credits.

Authority to Purchase

We have already observed that there is lacking in the authority to purchase issued by Far Eastern bankers to their agencies and correspondents in this country, any engagement that the drafts which the beneficiary draws on the buyer will be honored. Full recourse is had by the bank on the drawer until the drafts are liquidated. With that understanding the Far Eastern bank authorizes its New York branch or correspondent to advance the face amount of the bill.

Such a device is of less value than a revocable dollar credit, for it affords no protection against rejection of the goods and draft on arrival. It has value only to merchants who are satisfied with the buyer's integrity but lack sufficient capital or credit to finance on their own name all the business offered them. It fulfils one of the legitimate functions of the commercial credit device in that it puts the burden of overseas finance on the buyer, but, so far as protection to the beneficiary is concerned, it has no real value. In that respect it must be regarded simply as the equivalent of a favorable credit report on the buyer.

Accommodation Draft on Buyer

Now let us subject our newly accumulated knowledge to the acid test by applying it to the really puzzling form of credit issued by some Far Eastern bankers. The Dai-Ichi Ginko, Ltd., credit (Figure 14, page 65) is representative of the types. It provides for the payment by its New York correspondent, in dollars, without discount, of the amount of the beneficiary's draft, but compels him nevertheless to draw the draft at 90 days after sight on the accredited buyer in the Far East. Is such a credit nothing but an authority to purchase in disguise? Might the Dai-Ichi Ginko, Ltd., in the event that the accredited buyer failed to pay the draft at maturity, return it to the National City Bank for the purpose of suit, if necessary, against the beneficiary, based upon the prevision of the Negotiable Instruments Law previously quoted?

It is the opinion of several competent students of the subject that there would be no recourse in this event against the drawer by a holder who had knowledge of the circumstances under which the drafts were drawn.

To quote from one such opinion, given by Omer F. Hershey of the Baltimore Bar:

> The New York bank represents that it has received monies to the use of the beneficiary to be paid to him upon performing the conditions of the letter. One of these conditions is that in order that the Far Eastern bank, which has put the New York bank in funds for the purpose of the letter of credit, may be reimbursed, a draft shall be drawn to its order upon the buyer-holder. It seems evident, from the whole transaction, that a drawer of the draft does this simply as a means of enabling the Far Eastern bank to get its money and that the draft is not an ordinary independent business transaction to be judged as such. Any one who had notice of the whole transaction of which this forms a part, would, it seems to me, have notice that the Far Eastern bank had advanced money to the New York bank for the credit of the buyer-holder, which money the New York bank by contract with the Far Eastern bank held to the use of the seller-addressee, and consequently there could be no claim on the part of the Far Eastern bank unless by virtue of the literal tenor of the bill of exchange. But that bill, without any violation of the parole evidence rule, could be shown to be a part of the general transaction.

As there is no discount market in the Far East in which the issuing bank can discount these drafts after acceptance, it is probable that they are utilized simply to give the issuing bank an accepted draft as evidence of the accredited buyer's obligation to it. They apparently serve no purpose which cannot be achieved, as is done in other countries, by the use of an adequate agreement to reimburse given by the accredited buyer to the opening bank. However, there would appear to be no objection to the continuance of their use if the beneficiary was permitted to draw such drafts without recourse, and thus to give notice to holders of the true character of the drafts.

Recourse and the Uniform Commercial Credit Instruments

In drafting the uniform commercial credit instruments, the Commercial Credit Conference regarded it as unnecessary to consider the question of recourse, as related to the irrevocable credit (Figures 21 and 22) and the confirmed irrevocable credit (Figure 23). These forms derive their effectiveness, so far as the beneficiary is concerned, from the fact that they contain a bank undertaking that his drafts will be honored. If the beneficiary regards this undertaking as satisfactorily securing the credit risk, he will not be concerned over the fact that holders of the drafts may claim that the right of recourse exists against him. If the beneficiary is uncertain of the protection afforded by the undertaking, then the credit itself is not suitable for his purposes and he should seek the protection he desires by asking for a credit opened or confirmed by a bank in which he has confidence, rather than to attempt to pass an unsatisfactory risk on to the negotiator of his draft by drawing without recourse.

The authority to pay, however, presents a different problem, as the inter-bank agreement, by which the opening bank undertakes to reimburse the advising bank for payments or advances made, conveys no rights of which the shipper may avail himself, and the advice of authority to pay contains no undertaking that the shipper's drafts will be honored. If the terms of the advice were to require the shipper to draw on the opening bank or on the accredited buyer, the shipper would have either to draw without recourse or assume the liability ordinarily attaching to the drawer of a bill of exchange, unless he could successfully evoke the plea that he was an accommodation maker. The Commercial Credit Conference reached the

conclusion that the question of recourse, in connection with the authority to pay, should not be left to conjecture or argument, and accordingly provided that both the interbank agreement and the advice should specifically restrict its use to drafts drawn on the notifying bank. When recourse is to be retained the Far Eastern authority to purchase should be employed, as it is entirely suitable for that purpose; where recourse is waived the authority to pay serves the purpose which was previously met by the unconfirmed credit.

Bank Guaranties

Foreign banks, at times, instead of issuing a credit instrument, communicate to the shipper, either directly or through the medium of a correspondent, the statement that they guarantee that drafts drawn in accordance with certain stipulations will be honored. If the drafts are to be drawn on the bank giving the guaranty, such an agreement is in its general aspect similar to a negotiation credit. Even then, however, there might be difficulty in construing it as an undertaking to accept, within the meaning of the Negotiable Instruments Law, and, even though so construed, it would protect only holders for value. It thus would not have the effect of a negotiation credit, as the drawer's, and probably a holder's rights, would have to be determined by the law of guaranty and not by the Negotiable Instruments Law. If the drafts are to be drawn on the buyer, this would undoubtedly be the case. It is a basic principle of the law of guaranty that a guaranty is to be strictly construed in favor of the guarantor. There is also always present the question of the authority of the bank to issue a guaranty. National banks in the United States, for instance, do not have authority to guarantee the debts or obligations of third

parties. Although recourse against the drawer of such a draft is in theory not unlike that of one drawn under a negotiation credit, the question is always important in such an arrangement, because of the practical difficulties in the way of enforcing the engagement that the drafts will be honored.

A Practical Instance

In July, 1920, a Christiania bank issued the following letter of guaranty:

By order and for acount of A/S Norwegian Import Company, Christiania, we hereby guaranty American Export Company, New York, the right payment of up to $6,500 against surrender to us of shipping documents covering fifty tons steel plate to be delivered the fourth quarter of 1920. This guaranty remains in force until December 31, 1920.

Shipment was effected and documents forwarded for presentation to the Christiania bank which, upon receiving them, replied by cable as follows:

Norwegian importer informs documents incomplete as Lloyds certificate missing. Claim certificate or guaranty that goods are certified. Further that some specifications do not agree and about four tons more shipped than guaranteed.

The American exporting concern replied by the following cable:

Your guaranty calls for full set of shipping documents only; does not specify Lloyds inspection certificate. We request you to make payment at once under your guaranty.

The reply of the Christiania bank was as follows:

When guaranteeing it is understood that documents are to be delivered as per contract. Norwegian importer refuses payment as such documents not delivered.

This was subsequently supplemented by a further cable reading:

> Guarantee is not identical with confirmed credit. Under guaranty if payment refused not entitled pay before eventual final judgment against debtor. Therefore in addition earlier stated reason regret cannot pay at present.

If the doctrine is established that a guaranty of such a character is not similar to a credit but simply an agreement to be secondarily liable and that all defenses which would be open to the primary obligor are open to the bank issuing it, it would destroy the usefulness of such a guaranty as an inducement to bankers to negotiate drafts. Such a guaranty cannot safely be considered as anything more than a form of credit insurance, and the drawer must expect that the bank which has negotiated his draft will, in case the drafts are dishonored, immediately demand the repayment of its advances, with interest, and remit the drawer to the pursuit of any legal rights which the guaranty may afford him.

Recourse No Cause for Anxiety

A commercial credit that protects is one that contains the irrevocable engagement of a responsible bank that drafts drawn in accordance with its terms will be honored. With that any credit is useful for the security desired, even though it be not confirmed to the beneficiary by a local bank and even though the right of recourse is held by the negotiating bank. Without that engagement the instrument is not entitled to be considered as coming within the scope of bankers' credits. If the credit is right, recourse is of no concern.

CHAPTER XIV

PROTECTION OF THE MERCANTILE RISK

The Mercantile Risk

We have said that a seller may legitimately seek a commercial letter of credit to protect himself against a buyer of doubtful credit responsibility. May a buyer legitimately supply the letter of credit for the purpose of protecting himself from an irresponsible seller? Of course, the seller is not paid until his shipping documents are surrendered to the bank which acts as negotiating or paying agent for the buyer's bank, and to that extent a commercial letter of credit protects the buyer.

These documents may, however, be fraudulent. The United States District Court for the Southern District of New York has recently had before it a criminal prosecution, based upon allegations that the beneficiaries of certain commercial letters of credit had shipped a bag or two of the commodities stipulated and altered the bills of lading obtained from the steamship company falsely to evidence the shipment of the quantity of goods required by the credits. They presented the bills of lading and obtained payment.

The documents may be genuine, but the commodity may not be that which should have been shipped. An honest but inexperienced beneficiary, for example, purchases from a local dealer and ships a number of barrels which are supposed to contain a chemical in crystalline form, but which turn out to contain water. The supplier has meanwhile disappeared, while the beneficiary has spent

the profit he has made and is penniless. The buyer in that case has little chance of getting satisfaction.

Moreover, the commodity as well as the documents may be that stipulated by the commercial letter of credit, but the terms of the contract of sale may have been modified, subsequent to the issuance of the credit, so as to require the seller to deliver a commodity of greater value.

This risk of departure by the seller, either inadvertently or by intention, from the strict letter of his obligation to the buyer, as evidenced by the contract of sale, is termed the "mercantile risk."

The Buyer's Dilemma

If the buyer establishes a commercial letter of credit in favor of the seller, which enables the seller to receive his money some time before the buyer can inspect the goods, or even the documents, how is the buyer to protect this mercantile risk? To what degree can the paying or negotiating bank be placed under responsibility to examine the documents which accompany the beneficiary's draft? Is it feasible to put on the negotiating or paying bank the duty of checking the seller's performance of the terms of the contract of sale? And if it is not, is a commercial letter of credit a one-sided device which protects the seller but leaves the buyer without protection?

Contract of Sale

Let us first consider how the attempt to use a commercial credit to protect the mercantile risk fits in with the legal aspect of the relationship of the parties to the credit. It has always been understood and has recently been reaffirmed in decisions reviewed in Chapters XVII

and XVIII, that the obligation of the bank which has issued a commercial credit to the seller of the goods as the beneficiary, is quite independent of the obligation between the buyer and the seller as such, evidenced by the contract of sale. A beneficiary does not become entitled to avail himself of a commercial letter of credit by performing the terms of his contract of sale, if the documents do not conform to the terms of the credit.[1] Nor is it a ground for an injunction against payment by the bank to the beneficiary that the terms of the contract of sale have not been complied with, if the documents conform to the terms of the credit.[2]

Insertion of Contract in Credit

The thought at once occurs that the accredited buyer may avoid the effect of these decisions by instructing the opening bank to incorporate in the terms of the credit either the contract of sale verbatim, or excerpts from it containing a minute description of the merchandise, the stipulations concerning the shipping date, and the like.

Let us see how this works out practically. A particularly striking example of the insertion of a detailed description of the merchandise is afforded by the following cabled credit, sent to its American correspondent by an Italian bank at the behest of an Italian buyer of goods:

Open credit No.......... favour American Rubber Export Company account Italian Rubber Import Company up to $12,000 including freight, insurance covering 3,000 kilos brown rubber as follows, No. 30—450 warps of 23 threads each; No. 34—300 warps of 10 threads each, 450 of 14, 900 of 20; No. 40—750 warps of 14 threads, 1200 of 20, 300 of 23, 450 of 30, 300 of 33; No. 44—

[1] International Banking Corporation v. Irving National Bank, page 259.
[2] Frey and Company, v. National City Bank, page 254.

450 warps of 18 threads; No. 52—300 warps of 23 threads each, 600 of 28; total 6,450 warps—shipment as soon as possible in two or three steamers.

It is worth while to speculate for a moment on such a request. What might the Italian bank and its customer expect to accomplish by the incorporation of this detail? Assuredly, the order, with its minute description of the goods, was already in the hands of the American Rubber Export Company. The receipt from the American bank of the advice of the opening of the credit would take on no added usefulness by being festooned with this redundant detail. The information must have, therefore, been imparted to the American bank with the idea that the bank would employ it in checking up the merchandise at the time the shipping documents were presented.

As it happened, the beneficiary of this credit, which is set forth here with no alteration except in the names of the parties, was one of the premier industrial organizations of the United States. If it had failed to fulfil its contract, the buyer would have had an adequate remedy against it by action at law for breach of contract. Had it, however, been a morally and financially irresponsible organization it would undoubtedly have taken punctilious care to invoice its goods to conform exactly to the terms of the credit, whatever their actual character may have been. Certainly, then, the Italian buyer could expect no protection against an irresponsible seller, unless he contemplated that the American bank would actually examine the merchandise. Undoubtedly he must have cherished a mental picture of the commercial credit department of the American bank taking a holiday on the water-front —probably as the guests of the delightfully surprised steamship company—and plunging joyously into the packing cases containing the 3,000 kilos of brown rubber,

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sedulously separating the 6,450 warps into neat heaps, graded according to the number of threads, and then repacking them—all for ⅛ per cent commission, which is to say, $15.

Banks Not Equipped to Inspect Merchandise

The proper function of a bank is to finance business, and the proper function of a letter of credit is to serve as an instrument of finance. The personnel of a bank are trained to gauge the credit risk; they are not merchants, and their knowledge of the technique of the various lines is necessarily fragmentary. As Judge Mayer said in the case of International Banking Corporation v. Irving National Bank, "The simplest words of art in commercial transactions often have a trade meaning; a yard may mean 1⅛ yards in one business and a yard exactly in another; design may mean one thing in silk and another in cotton." So long as a bank confines itself to banking, therefore, it is not equipped to play the rôle of inspector and appraiser. It endeavors to avoid the task whenever it can. When it must assume it, it does it with little credit to itself and small satisfaction to the buyer.

The following instructions which have been prepared and sent by a San Salvador coffee merchant to his customers illustrate how poorly the attempt to impose on the banks responsibility for checking the mercantile risk works out in practice:

Opening of Credits for Reimbursements

All reimbursements must be provided for in the way of a *confirmed irrevocable credit* opened with ***first class bankers,*** advised to us by the bankers themselves, as soon as the contract of sale has been closed between our Agents and the buyers, or directly between ourselves and the buyers.

It is not necessary that the bankers should send us long telegrams relating all particulars of the transaction connected with the credit they are opening in our favor. A short telegram will do, if only it contains the following indications:

Reference number of the credit opened in our favour;
The name of buyers for whose account the credit is being opened;
The amount of exchange placed at our disposal;
The number of bags of coffee sold to buyers;
The bankers' signature.

They can, if they wish, add the port of destination and the time of shipment. This, however, does not seem to us of much use, as the conditions agreed upon are being fixed through the telegrams exchanged between ourselves and our Agents or our direct buyers.

For instance: If we have sold to Messrs "Name and Co." 300 bags of Extra Prime washed Coffee, Assortment of 50% of Firsts and 50% of Seconds at $15 per 50 kilos, cost and freight Havre, shipment per steamer during June, July, reimbursement by our sight draft upon the National City Bank of New York, shipping documents accompanying our drafts. It would be sufficient that the National City Bank of New York wires us as follows:

"Reference 974 Name 6210 dollars 300 bags Citibank."

974 would be the reference number that we ought to write upon our draft, and the tenor of that telegram would be quite clear to us, meaning that our Agents had done the necessary to have reimbursement provided for under the conditions required.

We specially recommend to our Agents and Buyers to be pleased to give to their bankers their instructions as briefly as possible, omitting any particulars that have no practical interest for the bankers, *but are liable to induce to error some bank officers not sufficiently acquainted with the coffee business to be able to confront accurately our invoice with their instructions.*

A Few of the Many Reasons Why New York Banks Refused to Pay Drafts Issued upon Shipments of Coffee Effected Last Crop

Shipment of 500 bags upon whose Bill of Lading the freight clerk aboard steamer in Acajutla wrote in blue pencil "20 bags wet

by salt water." Drafts refused payment by New York bank because of that note, which was something done by steamer Co.'s employe when coffee was aboard steamer and out of our jurisdiction. We must call attention to the fact that coffee was insured against all damage or loss by policy of the buyers.

Shipment of 450 bags of Current unwashed coffee 250 of which were invoiced as such and 200 being "peaberry." Draft refused payment because our invoice did not say that the other 250 bags were "flats."

It is never necessary to tell anybody with a cursory knowledge of coffee that "peaberry" is only the accidental variety of round berry; and that it is always invoiced as such, and that it never amounts to more than about 5% of total crop; 95% of all coffee is "flat" and nobody ever describes it in any invoice as being "flat."

Sale was made of 250 bags Superior Unwashed Coffee and 250 bags of Fair Average current unwashed coffee to Goteborg. Shipment was effected and the coffee was invoiced as being 250 bags of Fair Average Current Unwashed Coffee and 250 bags of Superior Unwashed.

Draft was refused payment because in the invoice the 250 bags of Fair Average were invoiced on the first line and the 250 bags of Superior were invoiced on the second line!!!

All Bills of Lading start in by saying: "Received in apparent good order and condition from So & So, so many bags of Coffee &c &c &c." Some of the New York banks refused payment of drafts alleging that these Bills of Lading did not actually state that the Coffee had really been received aboard the steamer.

A Hamburg buyer's banker cabled the New York bank opening a credit for what the Hamburg bank described as "250 bags of Ungew Kaffe and our Invoice said 250 bags of Unwashed Coffee."

The New York bank refused payment because our description of the coffee did not accord with that of the Hamburg banker.

"Ungew," is a known and accepted German abbreviation for "ungewaschen" say "unwashed"!!!

A Chilian buyer opened a credit against shipment of 200 bags of Washed Salvador Coffee size "A." The invoice described these 200 bags as being Washed Salvador First countermarked "A."

It is a general rule that washed First are countermarked "A," second "B" and Peaberry "C" and anybody with a slight knowledge of coffee understands this.

The New York bank refused to pay draft and we never were

able to understand why, because the invoice described the 200 bags as being Firsts and being marked "A."

Detailed Description of Documents

Sometimes the buyer concentrates his passion for detail on the shipping documents. A recent Scandinavian credit reflecting an effort of this character read:

> Please open credit No. 000 for account of Danish Import Company in favor of American Export Company for about $3,900 plus discount and stamp ninety days against draft at 90-days sight and delivery of clean full set bills of lading endorsed in blank, official certificate of inspection for quality, insurance certificate, copy of provisional invoice for about 500 quarters of 480 pounds per quarter Number 2 Western Rye 2 per cent, more or less, at a price of $35.75 per 1,000 kilos c.i.f. Hamburg for shipment per SS "Mary Ann" or "Sarah Ann" from North American Atlantic and/or Canadian port, freight deducted if not prepaid, shipment in good condition, bills of lading to be made out to order and must read "received on board" or words to that effect, not "received for shipment," dated November/December 1921; the insurance must cover invoice amount plus at least 2 per cent profit, insurance Lloyds conditions and including London American Trade Association F. P. A. clause and usual Harter Act clauses.

It has already been suggested that bank clerks are not merchants; assuredly they are not insurance underwriters, nor freight-brokers.

If stipulations of this character are to be permitted to appear in commercial letters of credit, no banker will feel free to make a payment or negotiate a draft until he has enlisted the co-operation of a trade advisor and fortified himself with an opinion from counsel.

Extent of the Duty to Examine

At the outset of this chapter we inquired whether a commercial letter of credit was a one-sided device which

left the buyer without protection, and up to this point the evidence would appear to favor an affirmative answer to our inquiry. However, this evidence is intended, not to demonstrate that there is no way by which the buyer may seek protection, but that the wrong way to seek it is to attempt to impose strange tasks upon the banks. Before considering the means which are at the disposal of the buyer, it is proper, nevertheless, to point out that, under the Regulations of 1920, which are a fair exposition of the general understanding, American paying banks undertake that "documents will be examined with care sufficient to ascertain whether on their face they appear to be regular in general form." This, it will be recalled, is a greater responsibility than they are called upon to assume by the terms of the customers' agreement to reimburse (see pages 142-152).

Good Faith the Test

It is highly desirable that this increased responsibility should be undertaken by banks, because it gives scope for the operation of the greatest of all protections—good faith. On the paying or negotiating bank there rests a duty to examine documents with ordinary care, and for the negligent or dishonest performance of this task, which is to the detriment of the buyer, they should be responsible. However, the customary commission received for the performance of this task (as Justice Scrutton has pointed out, in the opinion quoted at page 97) is so small as scarcely to be compensation for the actual labor and expense involved, and gives nothing for any risk assumed. So long, therefore, as the commissions are to be fixed at this low level, a paying or negotiating bank which has acted in good faith is entitled to protection. The paying or negotiating bank could not, however,

demand this protection from the opening bank if the agreement between the opening bank and the accredited buyer permitted the buyer to take advantage of any irregularity, no matter how trivial. For example, a credit might stipulate "shipment New York to Malmo" at a c.i.f. price. The beneficiary might find that by shipping from Philadelphia he could dispatch the goods a fortnight sooner, examine his contract and find that it permitted such a shipment, ship, and be paid. This action would in no way harm the buyer, but if the market for the goods was falling, or exchange had gone against him, he might seek to throw the shipment back on the hands of the negotiating bank.

A bank which ill advisedly followed its customer's instructions to decline payment under such circumstances, would not only find itself involved in litigation, but, vastly more important, would find bankers everywhere unwilling to negotiate bills or act as paying agent under its commercial letters of credit, the usefulness of which would be destroyed.

The present agreement between the accredited buyer and the opening bank, on the one hand, and the customary understanding of the responsibility for the examination of documents in good faith between the opening bank and the paying or negotiating bank, on the other, are nicely calculated, therefore, to afford the buyer the maximum protection he is entitled to expect from that quarter, having in mind the compensation paid and the nature of the banking business.

A Certificate of Compliance

Even though one may agree that banks cannot with propriety assume the responsibility of interpreting the contract of sale, it is hard to escape the conclusion that

it is an anomalous situation which permits a seller to be confessedly in default in the performance of the terms of his contract of sale, and leaves the buyer nevertheless helpless to prevent him from collecting the purchase price by complying with the terms of the commercial letter of credit. The suggestion has been made, and while it has not met with favor, it is repeated here, that every commercial letter of credit should include, among the documents to be surrendered as evidence of the right to receive payment, a certificate by the beneficiary to the effect that the relative shipment complied with the terms of his contract of sale. A wilfully false certificate of this character would undoubtedly bring the offender within the criminal statutes of some states and countries, and it would not be difficult to bring influences to bear to supply additional legislation where it was needed. Such a certificate might not stand in the way of an outright scoundrel, but would certainly give pause to the overshrewd trader who is ready to take advantage, so long as it is "within the law."

The Buyer's Best Protection

The buyer's best protection is to select his seller with care. The only risk involved is a moral risk. The buyer who chooses to deal, and to make his bank and its correspondent deal, with a morally irresponsible seller should bear the consequences. It is agreed among reputable merchants that a fair division of the risks in commercial credit operations puts the credit risk on the bank and the mercantile risk on the buyer. At a meeting in New York City held in June, 1921, and attended by representatives of leading mercantile and banking interests, the consensus of opinion reached was that the proper function of a bank in issuing a commercial credit was to afford a

means of financing the transaction. The attempt to place responsibility on banks to check the proper execution of the terms of the contract of sale between buyer and seller by incorporating a description of the merchandise or other features of the sales contract in the credit, was felt to be in the long run more harmful than helpful to foreign trade.

Mercantile Certificate

As already suggested, this does not mean that the bank cannot act in any degree to protect the buyer. It is entirely feasible to include among the stipulated documents a certificate issued by an accredited agency. Inspection of merchandise for export is not, in itself, a new practice. Certificates of quality are now issued to cover almost every conceivable commodity. The most notable examples are as follows:

GRAIN. Grain shipments are inspected in New York by the New York Produce Exchange and in other ports by similar organizations. The inspection is made in conformity with standardized grades that have been established by the United States Department of Agriculture, and such inspection is more or less under the supervision of this department. Certificates of quality are issued specifying the grade, kind, and condition of the grain. Weight certificates are issued by the elevator which delivers the grain to the steamer.

RICE. Rice is inspected at the Gulf ports by various organizations, notably the Rice Millers Association and the local boards of commerce. Samples are drawn from export shipments at the dock and passed upon by an appointed committee. Certificates are issued which show the grade, kind, and condition of the rice. The rice is also tested for moisture content and the percentage noted upon the certificate. A standard system of grades is maintained, but these grades are relative rather than constant, depending more or less upon the crop average and thus varying somewhat from year to year.

COAL. Coal is inspected at the coal ports by the Tidewater Exchange. This exchange controls the pooling of the coal according to its quality or grade and the district from which it comes. When delivery is made to steamer the Tidewater Exchange issues a certificate denoting the pool from which delivery is made. Certification is also made as to weight.

FLOUR. Flour is inspected in New York by the New York Produce Exchange and in other ports by similar organizations. A representative sample is withdrawn from a certain percentage of bags in a given lot and delivered to the buyer in a printed sack bearing identification marks and result of inspection. Certificates are issued covering only the condition of "soundness and uniformity" of the flour. No statement is ever made covering quality or grade.

MEATS AND PROVISIONS. The Bureau of Animal Industry issues a certificate covering meats and provisions. This is merely a health certificate and does not in any way denote the actual quality, grade, or merchantable value of the product. Such certificates are required by the government on all export shipments, the steamer not being permitted to carry such products until certificates are produced. The Board of Trade in Chicago and other packing house cities issue certificates covering grade and quality, inspection being made in the packing house. The New York Produce Exchange appoints private concerns as official inspectors for the performance of such services when goods arrive in New York.

DRIED FRUITS. Inspection and arbitration covering dried fruits is provided by the Dried Fruit Association of California and by similar organizations in other sections. Certificates are issued covering quality, grade, and size.

CANNED GOODS. The National Canners Association have established standards of quality and grades of canned foods and issue certificates of inspection covering these points.

FISH. Export shipments of fish are inspected and graded by the Preserved and Salt Fish Dealers Association of New York. Certificates are issued covering quality, grade, condition, and size.

COTTON. Ample provision is made for the inspection and grading of Cotton in the South Atlantic and Gulf ports. The New Orleans Cotton Exchange is a notable example. Elaborate and comprehensive regulations have been established by this exchange for scientific grading and classification of cotton shipments and for transportation, storage, and weighing, all of which

is conducted under careful supervision. These standards and grades are made to conform with the regulations of the United States Department of Agriculture. Certificates are issued covering grade, conditions, and weight.

COTTONSEED PRODUCTS. The Interstate Cottonseed Crushers Association provides for the inspection and grading of the following products: cottonseed oil, soap stock, cottonseed cake, cottonseed meal, cold pressed cottonseed, linters, hulls, peanut oil, soya bean oil, and cocoanut oil. Standards for quality and grade are established and provision is made for sampling, inspecting, weighing by official inspectors. Certificates of quality are issued.

LUMBER. Standards of grades and classifications of lumber have been established by various organizations, notably the following:

The National Hardwood Lumber Association
The Southern Cypress Manufacturers Association
The Southern Pine Association

The specifications for grades, sizes, and condition of lumber adopted by these organizations are the basis for official inspection certificates which are issued by each.

Development of Certificate

Irving L. Marsh, a traffic manager who has given thought to the problem presented, has proposed that the mercantile risk be even more adequately safeguarded by the creation of a bureau of inspection for export shipments. A statement of the plan he has formulated is as follows:

There is a very pressing and definite need under existing conditions of some agency through which the interests of the foreign buyer could be effectively protected and the responsibility placed in regard to delayed shipments—damaged merchandise and merchandise not of the quality purchased. It is probably safe to say that the shipment which reaches its destination without giving rise to any complaint or claim is the exception rather than the rule. It is worthy of note that consignees under letters of credit are beginning to demand unusual guarantees in the form of consular visés, affidavits, certificates of quality and other conditions,

many of which the banks are unwilling or unable to comply with.

The conditions against which the complaints arise may be classified as follows:

1. Dispatch of shipment:
   (a) Bills of Lading are frequently issued when steamer has not even arrived in port or is undergoing repairs or for other reasons is subject to delay.
   (b) Merchandise is often "shut out" with or without intention.
   (c) Another steamer is sometimes substituted.
   (d) The steamer may take several ports of call before arriving at the destination of the shipment—all without knowledge of the consignee.

All of these conditions seriously affect the consignee in his ability to fulfill his contracts and cause him losses in a falling market. These facts are never evident on the bill of lading and the practice of issuing bills of lading is greatly abused since the advent of many new and unreliable steamship companies. An investigation of all the circumstances surrounding each shipment is beyond the scope of a bank's activities.

2. Condition of shipment:
   (a) The delivery of merchandise of a quality not as ordered may be due to several causes, i.e., bad faith on the part of the exporter, carelessness in his deliveries—fault of his suppliers or mis-delivery of railroads—cross-deliveries by the steamer on account of inadequate or improper marking.
   (b) Damage or partial loss of contents may be due to improper packing (including failure to recondition), rough handling and in shipments of bags the use of hooks (a very prevalent and pernicious practice).

The steamer bill of lading does not reveal these conditions since in practice exceptions are omitted under guaranty of the shipper. The banks are of course unable to determine the condition of the shipment and the consignee is without protection.

In every export shipment at least five interests are involved, i.e., the shipper, the carrier, the insurance underwriter, the bank and the consignee. Even where the principals are parties of high standing and reliability, the impossibility of definitely placing the responsibility for loss, is always a serious obstacle in effecting an equitable adjustment.

The purpose of the plan proposed is to supply an additional document of a thoroughly reliable nature which will reveal all the pertinent conditions of the shipment so that the consignee, his agent, or other intermediaries in the negotiation of the draft are in possession of all information required for full protection. Incidentally, this plan will make it possible to definitely fix responsibility in the event of a controversy, and furthermore will be effective in discouraging many pernicious practices which operate to nullify all attempts to expand American commerce.

The Advisory Committee on Commercial Disputes in Foreign Trade, which was constituted in 1921 at the suggestion of Secretary of Commerce Herbert Hoover, by representative banking and mercantile associations to consider steps to be taken to prevent trade disputes arising from foreign transactions, after due consideration recommended as an ultimate, fundamental need, some agency "to provide that before shipment the quality of merchandise may be authoritatively passed on. This," their report continues, "would prevent in the great majority of cases refusals of merchandise at destination on grounds of alleged defects."

The general recognition of the need of an adequate protection of this character, for both buyer and seller, has encouraged Mr. Marsh to form a company, consisting of men themselves disinterested in merchandising operations, which offers a service which consists in brief of checking up the contract of sale upon delivery to steamer. A certificate of survey is issued covering in detail the facts relating to dispatch of shipment, condition of packing, port-marks, brand-marks, quantities, and stowage.

Samples are drawn from the merchandise as delivered and filed under seal for reference. Certificates of quality are issued if required. A system of registration of samples is also maintained to facilitate greater accuracy in the sale of merchandise by sample.

Engineer's Certificate

If the commercial letter of credit is intended to finance, for instance, shipments, in various parts, of a complete unit, it is not uncommon to stipulate that the beneficiary must provide an engineer's certificate with each shipment, indicating that the part in question has been properly constructed and is being sent forward in proper relation to the whole. Of a somewhat similar character is the Lloyds certificate issued with relation to ship's plates.

Payment of a Percentage

Where other plans of protection seem inadequate, the buyer can offer the seller a commercial letter of credit for, say, 90 per cent of the invoice cost of the goods, and by thus making the payment of approximately all the profit contingent upon a satisfactory inspection of the goods, upon arrival, secure himself against anything except flagrant fraud. And to the buyer who chooses to deal with a seller capable of deliberate bad faith, we need give no consideration, for he deserves none.

CHAPTER XV

COLLATERAL USES OF COMMERCIAL CREDITS

An Arrangement for Local Credit

Commercial letters of credit of the types we have been considering are usually not available to the beneficiary until ocean shipment has been effected and he has possessed himself of the shipping documents. It is often the case, however, that a commercial credit is issued in favor of a beneficiary who is a buying agent, or who stands in some other confidential relationship with the accredited buyer. Importers of rice or cotton, for instance, usually find it to their advantage to send buying agents into the producing districts to purchase directly from the growers. A commercial credit which gave the buying agent authority to negotiate documentary drafts would not make the funds available to assist in assembling the merchandise in some shipping center, unless local bankers could be persuaded to make advances against the goods in the belief that the relative drafts and documents would reach them in due course. In such a case the importer may not want to depend on the good graces of local banks in assisting his agent in assembling the merchandise, and may ask his bank in issuing the credit specifically to authorize the notifying bank to do so. A credit with such a provision is known as a "packing" credit and the authorization for it is made by including in the instrument the so-called "Red Clause," which reads as follows:

In the event of................(*the beneficiaries*)............ informing your branch at............(*location*)............that ....(*they*)..............require temporary advances to enable..............(*them*)..............to pay............. for the.............(*merchandise*).............for the purpose and shipment of....................which this credit is opened, your branch at..........(*location*)..........is hereby authorized to make such advances, which are to be repaid, with interest, from the payment to be made under this Credit, I/We undertake that should they not be repaid to the bank by.............. ....(*beneficiaries*)............in terms of and during the currency of this Credit, I/We will repay them with interest accrued to date.

It is understood that the making of the temporary advances or the payment to............(*beneficiaries*)............above referred to shall be optional on the part of your branch.

This credit is to remain in force after the..............19.....

A Means to Obtain Local Credit

May the domestic financing of a beneficiary who is assembling goods for shipment be undertaken by the notifying bank, or by any local bank with which the instrument is deposited, if the credit is in the circular form, of its own volition and on its own responsibility, without consultation with or the knowledge of the opening bank or of the buyer? If sufficient safeguards can be created, business of this character would naturally be attractive, as the fact that the export sale of the goods has already been effected and the means for the reimbursement of the seller already furnished, makes it absolutely self-liquidating.

Not all types of credit furnish adequate safeguards. If it is in the circular form, a mere deposit of the instrument will not prevent the beneficiary from negotiating drafts elsewhere, unless, as is usually the case, it stipulates that drafts negotiated must be indorsed thereon. Though forms of commercial credits may differ in

other particulars, each is alike in relieving the beneficiary of the burden of financing the overseas shipment of the merchandise. Whether it be a confirmed or irrevocable credit, or simply an authority to purchase, it accomplishes this end. As we come, however, to consider the extent to which a commercial credit can be used as security for domestic financing, we find it to be of little value unless it is irrevocable.

That fact can be best appreciated by taking, for illustration, the case of an exporter who is without capital and cannot command credit at his bank, but who has been fortunate enough to secure an order for a cargo of coal at $15 per ton, c.i.f. foreign port, from a buyer who has established a commercial credit in his favor for his reimbursement. In what ways may the commercial credit be used to assist him in executing the order?

1. Transfer in Whole

Our seller may find a local merchant who is able and ready to make the shipment and provide him with the c.i.f. documents stipulated in the credit for $14.50 per ton. The local merchant, however, for his own protection during the period in which he is assembling the cargo, and for his reimbursement after shipment has been effected, will, in turn, require a commercial credit. The seller therefore asks the bank which has notified him of the opening of the credit, or with which he has deposited it, to open a subsidiary credit for his account in favor of the local merchant, identical in terms except that the price will be $14.50 instead of $15 per ton.

Many of our banks have declined to undertake such an operation for a beneficiary for whom they would not independently undertake operations, but in so doing they have declined an opportunity to make a double commis-

sion on one risk; in fact the operation can be tripled or quadrupled. The beneficiary of the subsidiary credit may himself be simply a broker who has purchased at $14 from another broker, who, in turn, has purchased at $13.50 per ton from the actual supplier and shipper.

The one precaution necessary to make the piling up of these subsidiary credits, one on the other, a safe and profitable operation, is to procure from each transferor, at the time he requests a transfer, his own invoice at his contract price. The bank has, of course, no right to disturb the relationship of the parties to the various contracts of sale. It must be in position to present the invoice of the proper seller to each buyer. With these invoices in its possession, the bank is amply protected against any emergency. When the actual supplier and shipper of the coal presents his documents they will, if they conform to the terms of his subsidiary credit, comply with the terms of all the other credits, as they are all identical except as to price. The bank will then pay the supplier $13.50 per ton and give his invoice to the last broker, paying him 50 cents per ton, less the bank's commission for issuing a subsidiary credit. The last broker's invoice at $14 will then be turned over to the intermediate broker with the payment of 50 cents per ton, less commission. The invoice of the intermediate broker at $14.50 will then be turned over to the first broker with the payment of 50 cents per ton, less commission, and his invoice at $15 per ton with the remaining documents which have been successfully applied to each credit will be sent abroad to the opening bank, thus completing the transaction. The opening bank and the foreign buyer will, of course, be unaware of the existence of the subsidiary financing.

The local bank can undertake such operations with

equal safety though the original credit be revocable, providing the subsidiary credits are revocable also, as the subsidiary credits can be simultaneously canceled in case of the cancellation of the original credit. However, it is rarely indeed that the actual supplier is ready to charter his vessel, load it, insure the cargo, and take the risk that upon presentation of documents he may be told that the credit has been canceled. To be of much practical use for the purpose of transfer, therefore, the original credit must be irrevocable.

2. Transfer in Part

Let us now assume that our seller has found a local coal dealer who is prepared to deliver the coal on board a vessel, a carrier who has a vessel ready to receive it, and an insurance company which is prepared to insure the cargo. Each stipulates that the seller must furnish a commercial credit for its reimbursement. The seller can then ask the local bank to open subsidiary credits in favor of coal-owner, carrier, and insurance company, identical in terms, except that the first credit will undertake to pay the coal-owner $5 per ton for the coal supplied, the second to pay the carrier $8 per ton for ocean freight, and the third to pay the insurance company $1 per ton for insurance. Each subsidiary credit, while requiring a complete set of shipping documents, will contain a statement to the effect that it is understood that the bill of lading is to be furnished by the coal-owner, the freight bill by the carrier, and the insurance policy by the insurance company. When shipment has been effected the carrier will send the bill of lading to the bank, to be surrendered to the owner of the coal when the bank pays the carrier his freight money, while the owner of the coal will surrender it to the bank against

payment of his invoice for the coal. At the same time a representative of the insurance company appears with the policy, to be surrendered against payment of its bill for premium. The successful operation of such a credit requires some co-operation among the various partial transferors, but by working together they can make the transaction run smoothly. The bank takes no risk, as it has not committed itself to pay anyone until the triumvirate have presented it, collectively, a complete set of documents. When these are at hand each is paid his share, totaling $14 per ton, and their invoices are surrendered to the original beneficiary against his invoice at $15, which is sent overseas with the documents. Such an arrangement is hardly of practical use unless the original credit is irrevocable.

3. Assignment

Instead of asking the issuance of a subsidiary credit, the beneficiary may request the bank which has notified him of the issuance of the credit to assign it to his supplier. He may simply notify the bank that he has assigned it to the supplier or the supplier may notify the bank of the assignment. There is much uncertainty among the American banks as to their duty under any one of these circumstances. The Federal Reserve Board questionnaire made this inquiry:

Do you permit a beneficiary to assign his credit (all rights) to another person and have the documents presented in the beneficiary's name and not in the name of the party to whom the credit was transferred?

Dr. Edwards' analysis of the answers is as follows:

Yes, 26; No, 30.

(a) When it is desired to make a credit available for one or

more persons other than the beneficiary, it is usually so opened. As bankers' letters of credit are negotiable in character it is always possible for the beneficiary to assign to another person by drawing his draft or giving a sufficient power of attorney.

(b) We do not permit a beneficiary to assign his credit to another person unless especially authorized to do so by the bank for whom the credit is opened.

(c) If the credit is assigned to another person it must be done in writing and the drafts must be drawn by the person to whom the credit is assigned, and must be in every way in accordance with the terms of the credit.

(d) If transfer is agreed to, then all documents subsequently presented must be in the name of the new party.

The results of the above answers indicate that there is no definite usage regarding the assignment of credits to persons other than the beneficiary named in the credit letter. Some banks freely permit this practice (a), but it is customary to grant this privilege only with the consent of the bank authorizing the credit (c). When documents are later presented to the bank for payment, they are then surrendered in the name of the original beneficiary and not in the name of the new party (c,d).

From a legal aspect there is probably no obligation on a bank to recognize such attempts at assignment, as the inchoate right of the beneficiary to receive payment after the performance of the conditions stipulated in the credit is too intangible to be the subject of assignment. Undoubtedly the beneficiary of such a credit can, upon presenting the stipulated documents to the bank which is to effect payment and thus entitling himself to receive the money, make a valid assignment of that right to a third party. The beneficiary might virtually effect an assignment piecemeal by filing with the negotiating bank a power of attorney authorizing whomever he desires to draw in his name against any funds which might be due under the credit. Drafts might then be forwarded to the notifying bank attached to the necessary docu-

ments. The objection to this procedure from a practical point of view, so far as protection is concerned, is that such a power of attorney is revocable. The beneficiary, by revoking it, could thereby deprive his supplier of any protection which had been afforded by the granting of the power of attorney. Assignment does not appear to afford to the supplier of the goods absolute protection.

4. Security for Domestic Commercial Credit

Let us suppose that the order and commercial credit which our impecunious exporter has received do not call for the shipment of a commodity like coal, which is usually purchasable for export at seaboard, but for some commodity that is customarily sold f.o.b. factory at some inland point. Let us say that the order and credit relate to the overseas shipment of an automobile at $1,500, c.i.f., which is sold by the manufacturer for $1,000, f.o.b. cars, factory, Detroit. The issuance of a subsidiary credit on identical terms to the Detroit manufacturer will not bridge the gap in this instance. What risk would the local bank assume by issuing a commercial credit for the account of the exporter in favor of the Detroit manufacturer, available against railroad bill of lading and an invoice for an automobile at $1,000, f.o.b. cars, Detroit? Perhaps the most serious risk relates to the expiration date of the overseas credit. The date of shipment from Detroit must be fixed in the domestic credit at a period sufficiently in advance of the expiration date of the export credit to insure that the merchandise can reach seaboard, be packed for export, and the ocean bill of lading obtained within the life of the export credit. Consideration must also be given to the question of cost, so that the cost of the freight to New York, packing for export, ocean freight and insurance will be within the

$500 margin between the domestic purchase and foreign sale price. If these matters are satisfactorily disposed of, the operation can be undertaken without further risk. The negotiable bill of lading is surrendered into the hands of the bank which has issued the domestic credit at the time the automobile manufacturer receives his payment. This document, which controls possession of the automobile, can be surrendered by the bank to a reliable forwarder against his obligation to furnish the bank an ocean bill of lading made out in accordance with the terms of the export credit. When this bill of lading is delivered to the issuing bank it can assemble the insurance policy and beneficiary's invoices, liquidate its own advance, and pay the difference to the beneficiary as his profit.

Broaden the Field of Usefulness

The transfer of a credit in whole may be made, in safety both to the transferring bank and the transferee, without inquiring far into either the financial strength or moral attributes to the beneficiary who requests it. Transfer in part may be similarly made, but as between transferees there is some degree of dependence on each other's ability to perform their part in the transaction. Assignment is safe from the bank's point of view, but its usefulness to the assignee is dependent upon the beneficiary's integrity. The use of an export credit as security for a domestic credit demands not simply integrity, but also business ability from the beneficiary, so that the hiatus between the domestic and foreign shipment may be filled without miscalculation. Used in its proper place, however, and with due appreciation of the elements of risk involved, any of these methods broadens the field of usefulness of the overseas commercial letter of credit.

CHAPTER XVI

THE LETTER OF CREDIT AS A TRADE WEAPON

Disappearing Export Merchants

During the war period, when credit expansion was the order of the day, the number of export merchants and commission houses operating in New York enlarged in proportion to the increased volume of business. In that time of constantly rising merchandise values and easy money it was not difficult for these houses to secure commercial letters of credit from foreign buyers and to obtain enough domestic credit from local suppliers to bridge the gap until shipment was made.

During the present period of credit contraction, these houses have found both these tasks increasingly difficult. The domestic seller now requires cash against railroad bill of lading, dock or warehouse receipt. The foreign buyer feels that he is now trading in a buyer's market and is entitled to ask the export merchant to draw on him. As the gap has widened, export merchants and export commission houses have fallen through to oblivion. If this situation continues only houses with ample capital and liberal bank credit can survive.

Lessened Distributing Power

Some deflation of our export machinery was inevitable and advisable. There was a salutary effect to be derived from the elimination of incompetent and dishonorable merchants. That accomplished, there is left a body of skilful

and reliable foreign traders whose continued application to the problem of exporting our surplus products is a national necessity. Their aid is needed, not as clerks or even as officials in large export houses, but as they are at present—independent merchants with the initiative, versatility, and adaptability that come with small owner-managed concerns. If it is possible to do so—and it is—this distributing power must be maintained for the beneficial contribution it can make to the problem of marketing the last 20 per cent of our national production, which is the profit-maker.

A Fair Policy

It is a fair question to ask whether the richest and most powerful nation on earth should add to the difficulties of our prospective customers, already almost overwhelmed by the exchange situation, by forcing them to continue to bear the burden of supplying bank security. Can we afford to require them to establish commercial letters of credit to save our small exporters from extinction? The answer is not the one that at first glance would appear obvious. The extension of the use of commercial credits, far from handicapping our foreign trade, will be found to put it on a more solid basis than can be attained in any other fashion. It is in fact only in this way that it can hope to retain its vitality through the period now facing it.

No matter how overburdened with goods our shelves may be, no matter though the deluge of inflowing gold glut our vaults and our banks cry out for business to finance, we cannot escape disaster unless the credit we extend our foreign customers is on a fundamentally sound basis. Plan after plan has been devised to aid our export trade, by the extension of governmental aid and the creation of new types of banking institutions, but they have

all been sterile of results because they cannot escape the fundamental proposition that what we need is not increased banking facilities, but better banking risks. If the commercial credit plan is calculated to secure the risk in better fashion than is possible under any other plan, if it can be used in such a fashion that the actual financing will be done by American banks and the funds required for the transaction be obtained from the American discount market, and if all this can be accomplished at a cost which is in the final analysis less than any other method, then it is not simply a fair policy, but the only sound policy to adopt.

The Local Banker

Modern business has never seen an era in which it has been so difficult to gauge a credit risk. The whole world is in a political and economic condition so abnormal that ordinary signs and precedents have lost their virtue. The movement of events is too rapid to afford adequate protection to one who is not in intimate contact with the local conditions surrounding a debtor. Even in normal times the source to which a merchant should naturally turn for credit is his local banker. His banker not only can judge the safety of the individual risk but, with his institution being the reservoir of the liquid funds of the community, can sense the credit situation in its larger aspects. Certainly then, when American merchants turn to the foreign field under conditions which accentuate the credit risk, there is no other way in which they can obtain the protection which is afforded through its evaluation by the buyer's bank.

A Corrective against Overbuying

In both domestic and foreign trade, any method of financing which places on the seller the burden of furnish-

ing the capital or credit to carry merchandise during the period of transit, and particularly during the period required to liquidate it after arrival, is inherently weak. Credit may be overexpanded, though the sellers are amply good for the credit given them. It is the ability of the buyer to liquidate his purchase which supplies the preventative against overexpansion. If the seller draws on the buyer, and then discounts the draft, the buyer can accept the draft upon presentation, but postpone until maturity consideration of how he is to pay it. If, however, at the time he places his order, he is required to see his bank and arrange for ultimate liquidation of the draft, he will be forced to consider his transaction from its financial aspect from the outset. He will also have the benefit at that time of the vision of his banker, who might suggest factors which had not hitherto entered into his calculation. Recent American experience with the trade acceptance has demonstrated its ineffectiveness as a safeguard against inflation; the commercial letter of credit appears calculated to supply the corrective.

Mr. Alder, in the article already referred to (page 95), has given convincing testimony on this point. He says:

In October, 1919, at Atlantic City, during the International meeting called by the Chamber of Commerce of the United States, the President of a large financial institution of New York City made a statement to the effect that the American exporter was entitled to be paid cash upon delivery of his shipping documents to the banker and that such payment should be without recourse to the exporter, and that American foreign trade could not be maintained or increased if the bankers insisted that recourse to the exporter continued until all the bankers participating in the financing of the transaction were paid.

Had this policy been followed it is quite likely that American foreign trade would now be in a very much more satisfactory

position both from a banking and from a commercial point of view. It might, in fact it undoubtedly would, have curtailed orders to some extent during the recent boom period, but both the American banks and the American exporters would not have been in the condition of carrying unpaid accounts and unliquidated merchandise abroad, as has been the case during the past year. This unsatisfactory condition is largely due to the lack of proper or adequate financing by the foreign buyer at the time the orders were placed. Had the foreign buyer been required to arrange with his bank for the necessary financing at the time the orders were placed, excessive purchases would have been curtailed and the losses to American exporters and banks would have been very much reduced and the general result would be that American foreign trade would be in a prosperous financial position, ready to take full advantage of renewed foreign buying.

The American exporter cannot evade his responsibility for the present situation, for many orders were accepted without due regard to the necessity of financing by the buyer, and many of the recent losses have been the result of such failure to properly investigate the actual situation and take the necessary protective measures.

The International Banks

In the same way as the local banker can sense the local credit situation as a whole and thus parcel out accommodation to local merchants according to their merit, so our international banks can estimate the amount of credit that the local banks of any one foreign country are entitled to command from us. It is exceptional for the large American banks to extend credit directly to foreign merchants or manufacturers. Even where a direct relationship is established it is usually under the guaranty of the foreign customer's local bank. On the other hand, it is the practice of our international bankers, as of such bankers everywhere, to offer credit to deserving foreign banks. Our bankers, through their credit departments, keep in touch with each other's commitments of this char-

acter. In this way the volume of American bank credit which is made available for the bankers of any foreign country, and through them to its merchants, expands under the stress of competition and contracts when its total exceeds the margin of prudence. Our international banks through their branches and affiliations are sensitive to changes in foreign financial barometers long before our merchants can see the clouds overhead. They can tell equally well when the storm has passed before the evidence of clearing skies has reached our merchants. It is difficult to conceive a way in which the amount of our short-time credit to which any foreign country may be entitled can be so safely controlled as by rationing it to its merchants through its bankers.

A Warning

Recently a Kansas flour mill received simultaneously tentative orders from a Scandinavian and a Central European market. The Scandinavian merchant offered to arrange in reimbursement for his purchase an acceptance credit through his own bank and its correspondent bank in America. The Central European merchant stated that the cost of obtaining a bankers' credit was prohibitive and that he could not do business unless the seller were content to draw on him at sight. There could be no better illustration of the practical operation of the factors which have been outlined in this chapter than is afforded by this example. It is everywhere recognized that the political and economic condition of Scandinavia, and of her banks and merchants, is more stable than that of Central Europe. The result is that Scandinavian bankers are enabled to obtain from American banks and to offer to our prospective Scandinavian customers, sufficient banking credit to enable them to furnish commercial letters of credit to

American merchants. On the other hand, the amount of credit which American banks are willing to give to Central European banks under present conditions is of necessity limited. Undoubtedly the Central European banks, in rationing the small stock of credit at their disposal, charge their customers a larger commission than would be usual in normal times, but it is more than likely that the small Central European importer is deterred from offering credits, not because of the cost, but because the Central European bank is unwilling under present conditions, to give him part of its slendor stock of credit at any price.

The American merchant who, in the course of negotiation with prospective foreign customers at the present time, is met with the plea that the buyer is unwilling to establish a commercial credit in favor of the seller, should scrutinize with the greatest care the reasons advanced for the refusal. In almost every case it will be found that the refusal results from the inability of the buyer to obtain the requisite credit from his local bank, or from the inability of the local bank to command credit from American banks. The result is that our American merchant is being invited to undergo a credit risk that banks which are in a better position than he to appraise it, have declined. It may be that by declining to do business except on commercial credit terms our merchants will lose business, but the business they lose will, for the most part, be of the sort that it is better for them not to undertake.

When our merchants are asked to draw directly on foreign buyers at sight, cash against documents, there is always present the risk of having dealings with a rascally buyer who will refuse to pay the draft on presentation in the expectation that the seller will offer a rebate rather than seek a market elsewhere. In these times of violent and sudden fluctuations of values and exchanges the interval

between dispatch and arrival may render the transaction so unprofitable that a buyer who would resist this temptation may, in desperation, decide to risk the moral and legal consequences of rejection rather than assume the ruinous obligation of payment. When short-term credits involving the surrender of the merchandise to the buyer are required, the risk is largely accentuated. Obviously only a local banker who can watch the buyer during the interval between his receipt of the goods and payment, has an adequate opportunity to scrutinize and safeguard such accommodation. There is an obvious advantage, then, in passing short-term credits through the medium of the buyer's local bank, if the local bank's correspondent in the United States can handle short-term credits in sufficient volume.

Our Discount Market Supplies the Funds

It must not be forgotten in this connection that the burden of furnishing the funds for short-term credits falls ultimately on the banks in any event. If the seller draws directly on the buyer, the seller expects his bank to discount the draft. If a commercial credit is employed the only difference is that while in the first case the bank has extended credit to its domestic customer, in the latter it has extended it to the foreign bank. The drain on its funds is identical in either case.

Banks are simply the reservoirs of the floating liquid wealth of the community. The extent to which they have funds of their own to lend depends then upon the volume of trade which is building up the bank deposits which give the banks their lending power. In an era of falling prices these deposits decrease and the lending power of the banks diminishes accordingly. If there were no way in which our banks could finance foreign trade except to lend their

funds, the volume of foreign trade would of necessity have to shrink with the contraction of the lending power. The Federal Reserve Act has adequately safeguarded our foreign trade against such a situation by permitting national banks to lend, not cash, but credit, by accepting drafts drawn against them, having not more than 6 months' sight to run, which grow out of transactions involving the importation or exportation of goods.

Bank Acceptances

Member banks may, with the approval of the Federal Reserve Board, accept such bills up to 100 per cent of their paid-up and unimpaired capital stock and surplus. Under the regulations at present in force, federal reserve banks may rediscount any such bill having a maturity at time of discount of not more than 3 months, exclusive of days of grace, which has been drawn under a credit opened for the purpose of conducting or settling accounts, resulting from a transaction or transactions involving the shipment of goods between the United States and any foreign country, or between the United States and any of its dependencies or insular possessions, or between foreign countries. The board has further ruled that 6 months' bankers' acceptances issued in import and export transactions are eligible for open-market purchases by federal reserve banks.

National banks may properly enter into agreements for the financing of transactions of this character, by which they obligate themselves to accept drafts which in the aggregate extend over a period longer than 6 months. The period covered by such an agreement, and of any acceptance made in connection with it, must not exceed the usual or customary period of credit required to finance the

underlying transaction, or the period reasonably necessary to finance it.

Comparative Costs

The most common objection interposed by a foreign buyer to a seller's request for a commercial letter of credit is its cost. In answering this objection the seller does not necessarily have to choose between declining the business or choosing to take the risk of drawing on the buyer. He can regard the cost of obtaining a credit as an insurance premium and agree to assume it himself. On a basis of comparative costs this plan provides cheaper and more comprehensive insurance than is furnished by any other plan which has been suggested. While local custom and the safety of the individual risk are the deciding factors determining the charge which the opening bank exacts from the accredited buyer for its own commission, it is usually around ⅛ per cent for sight credits. The basic international rate charged by correspondents for effecting documentary payments is ⅛ per cent, and this rate is shaded where there is any considerable volume of business. For confirming credits it has been customary abroad to double the commission, and that practice is in course of adoption here. These three charges make the total cost of a confirmed sight credit approximately ⅜ per cent.

Unfortunately there is no basis on which to compare this cost with the cost of insuring the credit risk in the normal fashion, because there are no companies which make a general business of undertaking this class of risk. The British government attempted in 1920 to insure the credits of its merchants who were dealing with the weaker nations of Central Europe, by subsidizing a company which had, however, to place such restrictive conditions upon the risks that the plan proved abortive.

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During the past year a solution has been attempted by some middle western American merchants by the formation of a co-operative insurance company. This company plans, however, to insure simply the risk of the buyer's insolvency and that only in the case of buyers in the zones covered by its service who have been investigated and found to be financially responsible. It does not plan to insure the risk of rejection which customarily causes more trouble and loss than insolvency. It is not yet possible to ascertain the cost of this insurance, as it is planned that the initial premium is to be determined by the normal average exports and is to be adjusted at the end or during the course of the year to the actual transactions covered. This plan is open, therefore, to the objection that it covers only a small portion of the risk and that only in connection with certain approved names, and that it is impossible to calculate its cost at the time the sale is made.

It is entirely safe to say that the cost of this or any other insurance plan cannot be brought below that of the commission charged for establishing bankers' credits, because the banks need set up no new machinery to undertake the operation but can absorb the operation in their regular daily routine. The commercial letter of credit, therefore, furnishes comprehensive insurance through existing agencies at a minimum cost, and affords just the sort of protection that both British and American merchants have found indispensable under existing conditions. This protection is worth paying for, and American houses can better afford to pay it themselves than to take the risk that otherwise exists.

A Typical Instance

The O. and W. Thum Company of Grand Rapids, Michigan, makers of Tanglefoot fly paper, in 1915 reached

an understanding with practically all of their foreign agents that they would supply commercial letters of credit on New York banks, agreeing in turn with their customers to pay the bankers' commission for issuing the credits. This company has also given its agents the alternative of opening, instead of sight credits, acceptance credits of 30, 60, 90 days, or even longer periods, the rate of discount being diminished accordingly. It regards the slight expense of paying the bankers' commission for the accommodation as being more than offset by the advantages to be gained from the arrangement.

Other Methods More Costly in the Long Run

It runs counter to business experience to expect that the concentration of our export business in the hands of a comparatively few powerful houses which are able to finance their entire volume of business on their own account would lessen the eventual cost to the rest of the world of dealing with us. These merchants would have to calculate in their cost the hazard of accepting a mercantile instead of a banking credit risk. In addition the ability to finance foreign shipments is a valuable facility for which foreign buyers would have to pay. Like a tax which is ostensibly paid by the importer but which is actually passed on to the retailer and eventually to the consumer, the cost of doing business is reflected in the price. There is but one way to bring our quotations to the lowest competitive levels, and that is to bring every element which enters into the quoted price into its most economical form. Taking into consideration all the factors involved, including the risks, there is no method by which American foreing commerce can be financed which will impose so light a burden upon the commerce as the commercial letter of credit plan.

Request for a Commercial Letter of Credit Not a Reflection on the Buyer

The history of business is replete with instances in which economical and convenient methods of doing business had to be waived in favor of more burdensome ones as a concession to prejudices of the buyers. Is it likely that the seller's request for a commercial letter of credit may be regarded by the buyer as a reflection on his credit standing? As a matter of fact, it is quite the reverse. The buyer and seller, in dividing the burden of foreign trade, must apportion to each other the tasks which each is best equipped to perform. If the seller is not strong enough to finance the shipment and the buyer is, then the request that the buyer should use his credit standing to finance a shipment by furnishing the seller a commercial letter of credit compliments the buyer by admitting his superior standing. If the seller is strong enough to finance the shipment and still seeks the credit, it is because he wants the principle of insurance to apply to his credit risk, just as it does to his fire risks and his marine risks.

There is no more reason for the buyer to resent the efforts of the seller to insure himself against unforeseen financial reverses than for the master of a ship to resent the action of the cargo-owner in seeking insurance against the unforeseen perils of the sea. It is assumed that the master has properly manned, equipped, provisioned, and fitted out his vessel, and that she is seaworthy and capable of performing her intended voyage. So it is also assumed that the buyer is conducting his business with ordinary prudence and has surrounded it with the customary safeguards which careful business men employ. In either case, unless these precautions are taken, no man is justified in entering into a business relationship with him.

The best evidence that the adoption of the commercial

letter of credit method of financing is not a reflection on the buyer's credit standing, is that the instrument is used in the world financial centers where merchants are strongest. No nation has employed it as extensively as the British, and its most persistent use in this country has been by the strongest and best reputed American merchants in financing their importations of merchandise to this country. There is no occasion on the part of any merchant to feel that the resort to the commercial letter of credit method of financing his purchases is a reflection on his credit standing.

The Prospect for the Future

One of the national banks which has taken a leading part in our transition from a provincial to an international banking viewpoint said, in a pamphlet printed shortly after the passage of the Federal Reserve Act, that there was little chance that this country would ever come into competition with the established international bankers of London, Paris, and Berlin. Yet on April 1, 1920, according to a survey made by the American Acceptance Council, the total volume of American bank and bankers' acceptances outstanding was $799,001,237.41. At the end of the next year this amount had shrunk to $664,092,113.39. This shrinkage was in some part accounted for by the fall in commodity prices, which made it possible to finance a much larger turnover of goods with the same or less amount of credit. Unquestionably our acceptance business has suffered heavily in the last year from the handicaps which have arisen, not from any defect in the principle of operation, but from the friction and disputes which have resulted from the haphazard development of the commercial credit instruments out of which most of our acceptances arise. It is fair to say, however, that while the foreign

financial centers shared with us fully the unpleasant experiences of 1920, it is the American banker and the American merchant alone who have taken effective steps to eliminate the possibility of their future recurrence.

Mr. Hartley Withers, the English economist, in his book on "The Meaning of Money," published in 1909, credited Americans with the cherished ambition to see New York established some day as the monetary center of the universe, and with natural resources and population sufficient to achieve their wish, if they could learn the necessary lessons and develop the necessary character. "And," he said, "an American can learn anything, if he thinks it worth while."

It took the commercial letter of credit some centuries to reach us. When it arrived, it was a crude implement on which to place reliance, either as shield or sword. We have, within a decade, forged it into a formidable weapon, uniquely adapted to consolidating the position which we cannot fairly say we have won, but rather which fate has put into our hands.

CHAPTER XVII

NATURE OF RIGHTS AND OBLIGATIONS CREATED BY DOCUMENTARY LETTERS OF CREDIT*

I. Theories as to Rights Created by Letter of Credit

To a business man nothing is simpler than the nature of the obligation created by an irrevocable banker's documentary letter of credit. The seller of the goods believes that if he has such an instrument he has the direct obligation of the issuing bank, running in his favor, enforcible by him against that bank, that it will pay his drafts, if drawn in compliance with the terms of the letter of credit. He cannot understand how there can be any difficulty upon this subject; and yet to courts and lawyers numerous difficulties present themselves. A fundamental difficulty is that, while the issuing bank gives its direct undertaking to the beneficiary of the credit, it receives no consideration from him therefor. The bank issues the credit to the seller at the request of the buyer, the buyer agreeing with the bank to pay to it a small commission, usually 1/8 to 1/4 per cent of drafts negotiated thereunder. This would, of course, be a sufficient consideration to support the contract, if it passed to the bank from the beneficiary of the credit; but the bank actually receives no consideration whatever from the beneficiary.

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*This and the following chapter were written by Carl A. Mead, and appeared in substance in 22 Columbia Law Rev., p. 297.

Another source of confusion is the fact that many of the earlier decisions of the courts relate to the old form of letter of credit, which was a mere request to a third person to advance credit to the beneficiary, and not the direct promise of the issuing bank in his favor. The courts have sometimes failed to discriminate between different forms of letters of credit; and most of the earlier decisions have no bearing whatever upon the rights and liabilities of parties to a modern documentary letter of credit. This situation has resulted in various theories in regard to the nature of the contract rights created by a letter of credit.

1. Offer and acceptance

It is sometimes said that a letter of credit is a mere offer of the issuing bank. This theory, however, does not meet the situation, for it is usually the intention of the parties that the credit shall be irrevocable from the time when it is issued; whereas, if it constitutes a mere offer, it is, of course, revocable by the issuing bank until the offer has been accepted by the beneficiary by some action in reliance thereon, such as procuring and shipping the goods.

2. Guaranty by issuing bank

Another theory is that the issuing bank is a mere guarantor of the obligation of the purchaser to pay for the goods. This theory again does not conform to the facts, since, by the terms of the letter of credit, the bank is not, like a guarantor, secondarily liable, but undertakes a direct primary obligation in favor of the beneficiary of the credit.

3. Liability of bank by estoppel

Another attempt to solve the difficulty is based upon the theory of estoppel. In the quaint language of Lord Coke (3 Co. Litt., p. 342) estoppel is referred to as follows:

A man's own act or acceptance stops or closes up his mouth to allege or plead the truth.

Estoppel involves an admission, statement, or act inconsistent with a claim afterwards asserted, also an action by another party in reliance thereon and injury to the other party. The representation must be as to past or existing facts and not a promise as to the future, which, if binding at all, is binding as a contract.

It is said that the bank, by issuing the letter of credit, represents to the beneficiary and to holders of drafts drawn thereunder that it has received from the purchaser of the goods sufficient funds to meet the drafts; and that, if this representation is not true, the bank should be held liable to anyone who has acted in reliance thereon upon the theory of estoppel.

There are various objections to this theory. First of all, it is very seldom that the issuing bank has received from the buyer of the goods any funds in advance of the issuance of the credit. The purchaser usually goes for such an instrument to his own bank, which is familiar with his credit standing. The bank well knows how much it is willing to advance on his unsecured obligation; but the advances may not be wholly unsecured, since the bank usually holds documents representing the title to the goods purchased as security for its advances.

Furthermore, even if the issuing of the letter of credit did amount to a representation that the bank had funds of the purchaser of the goods in its possession sufficient to meet the drafts, that fact alone would not be sufficient to make the bank liable upon the principle of estoppel. In order to make a person liable by estoppel, he must have made a false representation ~~as to an existing~~ fact. The representation in this case might be strictly true that the

purchaser of the goods had, at the time when the credit was issued, deposited funds with the issuing bank sufficient to meet the drafts. The letter of credit, however, involves the further representation that these funds will be held by the bank and utilized for payment of the drafts. This representation is not as to an existing fact, but is promissory in its nature, and consequently cannot be the basis of any liability by estoppel.

4. *Equitable assignment of funds on deposit*

Attempts have been made to work out the liability of the issuing bank upon its letter of credit on the theory that it has thereby made an equitable assignment to the beneficiary of the credit of funds belonging to the purchaser of the goods on deposit with it. The same objections exist to this theory as to the last, namely, that usually the bank has no such funds on deposit, and, furthermore, that that is not the intention of the parties; and it was long ago so decided by the British House of Lords.

Morgan v. Lariviere, L.R. 7 H. L. 423.

5. *Contract by issuing bank with buyer for benefit of seller*

Efforts have been made to solve the difficulty by applying the principles of Lawrence v. Fox (20 N. Y. 268), under which a contract made by one person with another for the benefit of a third may be enforced directly by the third person. This theory also does not fit the facts of the case, since the letter of credit is not a contract between the bank and the buyer, from whom it receives its commission, but between the bank and the seller.

6. *Direct contract by issuing bank to beneficiary of credit*

The most recent theory in support of this form of

obligation is that it constitutes a mere simple contractual obligation from the issuing bank to the beneficiary, supported by a consideration in the form of the commission paid to the issuing bank by the purchaser of the goods. This theory solves all of the difficulties involved, carries out perfectly the intention of all the parties to the transaction, and violates no recognized principles of law. On this theory, a so-called irrevocable letter of credit is irrevocable in law from the time it is issued, whether or not the beneficiary has changed his position in reliance thereon. No rule of law or principle of public policy is violated. It might be argued that the instrument should be supported, even though there were no consideration moving to the issuing bank, on the theory that it is a specialty, recognized by the law merchant. It is not necessary to go so far as this, however, since the issuing bank does receive a valuable consideration for its promise, in the form of a commission from the buyer of the goods; and it is now well settled law in this country that a contract may be suported by a consideration moving to the promisor from another than the promisee.

1 Williston, Cont. (1920), Secs. 114, 354.
Farley v. Cleveland, 4 Cow. 432, 439.
Rector v. Teed, 120 N. Y. 583; 24 N. E. 1041.
De Cicco v. Schweizer, 221 N. Y. 431; 117 N. E. 807.
Hamilton v. Hamilton, 127 App. Div. (N. Y.) 871
Cabot v. Haskins, 20 Mass. 83, 91.
Palmer Savings Bank v. Insurance Co., 166 Mass. 189, 196; 44 N. E. 211.
Crosier v. Crosier, 215 Mass. 535, 537; 102 N. E. 901.
Bell v. Sappington, 111 Ga. 391, 393; 36 S. E. 78.
Williamson v. Yager, 91 Ky. 282, 286; 15 S. W. 600.
Owenby v. Georgia Baptist Assembly, 137 Ga. 698, 701; 74 S. E. 56.
Van Eman v. Stanchfield, 10 Minn. 255, 261.

21 Columbia Law Rev. 176 (1921).
34 Harvard Law Rev. 533 (1921).

This principle of liability to the beneficiary named in the credit and to persons negotiating his drafts, upon the direct promise of the issuing bank was discussed and approved as long ago as 1867.

Re Agra and Mastermans Bank, ex parte Asiatic Banking Corporation, 36 L. J. Ch. 222.
Union Bank of Canada v. Cole, 47 L. J. C. P. 100.

It has also been adopted and applied in several recent cases; and it can now be regarded as well-settled law.

Sovereign Bank v. Bellhouse, Quebec Official Reports, 23 K. B. 413.
Gelpcke v. Quentell, 74 N. Y. 599.
American Steel Co. v. Irving National Bank, 266 Fed. 41.
Frey v. National City Bank, 193 App. Div. (N. Y.) 849.
Doelger v. Battery Park National Bank, Reported in New York Journal of Commerce and Commercial Bulletin, April 20, 1921.

In Sovereign Bank v. Bellhouse, the court held:

> Undoubtedly a person can induce a Bank to give him a letter of credit and may, by a subsequent line of conduct, justify the bank in cancelling it, but it is not the same when the customer induces the bank to give a letter of credit to a third person. In that case the customer cannot compel the bank to cancel the letter, because there is no contract between the customer and the bank but only one between the bank and the third party.

Gelpcke v. Quentell is one of the earlier cases in which the principle was recognized. The purchaser of the goods sought to revoke a letter of credit issued by the bank. The bank, however, declined to dishonor drafts

drawn under its letter of credit and, after paying them, sought to recover their amount from the purchaser, for whose account the credit had been opened. The court held that the bank was entitled to recover, saying:

> The defendant could not, by his revocation of the credit, escape liability to indemnify the plaintiffs against responsibilities which they had incurred or require them to violate contracts which they had made in pursuance of a letter of credit before notice of the revocation . . . By the terms of the plaintiff's agreement, which they made on the faith of the defendant's implied promise to indemnify, they were bound to accept the drafts; and they were not required to decline to accept after receipt of notice of revocation and take the chances of a defense existing, of which they knew nothing, but were entitled to perform their contract, and look to the defendant for indemnity.

In the recent case of American Steel Company v. Irving National Bank a similar question arose, and the Circuit Court of Appeals for the Second Circuit said:

> The law is that a bank issuing a letter of credit like the one here involved cannot justify its refusal to honor its obligations by reason of the contract relations existing between the bank and its depositor. . . There is but one vital question involved in this case. It is whether the letter of credit already set forth herein is a complete and independent contract between the plaintiff and the defendant. This court is satisfied that it is, and that by it the defendant gave authority to the plaintiff to draw upon it up to the sum of $43,250, and impliedly promised to pay drafts so drawn when accompanied by certain specific documents, to wit, the invoices and bills of lading, providing the drafts were drawn and presented prior to the expiration of the credit on June 13, 1918.
>
> The defendant, in effect, seeks to read into the contract a provision that the plaintiff's rights under the letter of credit should be subject to the superior right of the MacDonnell Chow Corporation to modify the contract which the bank had made with the plaintiff. We do not so understand the law.

In Frey v. The National City Bank, the defendant bank issued, for account of the plaintiff, in favor of Sherburne Company, which was also joined as a defendant, a letter of credit available by drafts with documents, representing a shipment of sugar from Java. The contract of sale provided that, if the steamer carrying the goods did not clear within a specified time, the buyers might cancel the remaining portion of the contract; but no such provision was incorporated in the letter of credit. The plaintiff, however, gave notice of cancellation of the contract and brought this action to enjoin the defendant Sherburne Company from drawing drafts under the letter of credit and the defendant bank from paying drafts so drawn. An order denying the plaintiff's motion for an injunction, pending the action, was affirmed by the Appellate Division.

In the Doelger case it was held at trial term that an irrevocable letter of credit, when its conditions had been complied with, was a contract by the bank to accept and pay drafts presented at any time before the credit expired; and the court expressed the opinion that if, even before the seller had bought any goods or changed his position in any way on the faith of the letter, the bank should repudiate its contract and announce that it would accept no drafts drawn thereunder, the seller would thereby be relieved of the necessity of performing and could recover from the bank the profit of which he had been deprived by the bank's wrongful act.

II. Assignability of Letter of Credit

Upon the question whether a documentary letter of credit is negotiable or assignable the earlier decisions, relating to the older forms of letters of credit, have little

bearing. As has already been pointed out, the documentary letter of credit is addressed to the beneficiary by name, authorizing *him* to draw drafts thereunder. Thus, its form clearly indicates that it is not intended to be either negotiable or assignable. It is like a power of attorney, authorizing the named person to draw drafts; and the attorney has no power of substitution, unless such power is expressly conveyed by the instrument itself. A letter of credit could, no doubt, authorize either the beneficiary, or any person designated by him in writing, to draw drafts under the letter of credit; but if it does not do so expressly, no such power exists. In the case of documentary credits, used in connection with a contract for the sale of goods, it is obvious that the parties do not contemplate the assignment of the letter of credit. The buyer and seller have made their contract of sale in mutual reliance upon each other. They may have known each other from a long course of dealing, or this may have been their first transaction; but, in any event, the buyer relies upon the seller to carry out his contract of sale. In fact, the buyer has placed peculiar confidence in the seller, because, in reliance upon his promise to ship goods of the kind and quality agreed upon, he has directed his bank to make payment against the documents. The relation, accordingly, is one of peculiar trust and confidence; and the banks constantly seek to impress upon their customers the danger of opening an irrevocable credit in favor of an unknown party. This being the case, it must be presumed that the buyer did not intend that any assignee of the letter of credit should be authorized to draw drafts thereunder, but that only the person with whom he contracted for the goods should have the authority. However, the drafts, if they are once drawn under the letter of credit, are negotiable.

Frequently an effort is made to assign an irrevocable documentary letter of credit, running to the seller of goods, to his bank as collateral security for a corresponding irrevocable letter to be issued by that bank to a person from whom the beneficiary of the original credit seeks to purchase goods to be shipped in fulfilment of his contract of sale. It is recognized, however, that such security is very uncertain; and it is not the practice of the banks to place much reliance upon it. If this security is taken, the bank usually requires the original letter of credit to be deposited with it, together with blank drafts, bearing the signature of the beneficiary of the credit, which can be filled in as to amount and date when the required documents are available.

CHAPTER XVIII

PERFORMANCE UNDER DOCUMENTARY LETTERS OF CREDIT

I. The Bank Must Comply Strictly with the Terms of the Letter of Credit

Both the negotiating and the issuing bank must exercise the utmost care in assuring themselves that the documents against which the draft is negotiated or paid, as the case may be, comply in all respects with the terms of the letter of credit. If they do not, the negotiating bank cannot recover from the issuing bank and the issuing bank cannot recover from the buyer of the goods. This question has come up in numerous cases; and it is uniformly held that the bank cannot recover if the terms of the letter of credit have not been strictly complied with.

The Brazilian and Portuguese Bank v. The British and American Exchange Banking Corporation, 18 Law Times 823.

The Chartered Bank of India, etc., v. McFayden & Co., 64 Law Jour., Q. B. 367.

Bank of Montreal v. Recknagel, 109 N. Y. 482, 490; 17 N. E. 217.

Lamborn v. Lake Shore Banking & Trust Co., 196 App. Div. (N. Y.) 504, 506; aff'd 231 N. Y. 616.

International Banking Corporation v. Irving National Bank, 274 Fed. 122, 125.

Diamond Alkali Export Corporation v. Bourgeois, K. B. Div., July 1, 1921, McCardie, J., 126 Law Times Rep. 379.

In Brazilian Bank v. British Banking Corporation, the letter of credit called for shipment from Rio de Janeiro to New York, Philadelphia, or Baltimore, and provided that all the bills of lading, except one to be forwarded by the vessel to New York and one to be retained by the captain, should be forwarded direct to the defendants in London. The bills of lading, when issued, showed shipment from Rio "bound for St. Thomas for orders," and one of them was retained by the shipper. As the requirements of the letter of credit had not been complied with, it was held that a bank which had negotiated the drafts could not recover from the issuing bank.

In Chartered Bank of India v. McFayden and Company, the letter of credit authorized drafts to be drawn thereunder "against produce bought and paid for." The beneficiary drew the drafts without purchasing the commodities; and it was held that the plaintiff, having discounted the drafts, in reliance on the good faith of the drawers, must take the consequences of any breach of good faith on their part, and could not recover from the defendant, which had issued the credit.

In Bank of Montreal v. Recknagel, the letter of credit called for a "full set bills of lading of 2500 bales Manila hemp." The bills of lading actually called for "bales of merchandise, weight and contents unknown." It turned out that the shipment was not hemp, as required by the contract. The issuing bank, having paid the drafts, brought this action against the purchaser of the goods; and it was held that it was not entitled to recover. Gray, J., said:

> The credit was authorized upon certain conditions, prescribed by the parties to be ultimately bound; which they not only had the right to make, but which were assented to by the plaintiff.

In Lamborn v. Lake Shore Banking and Trust Company, the letter of credit called for "bills of lading for 550 bags Java white granulated sugar." The bills of lading actually described the sugar as "550 bags of Java white sugar." A motion to vacate a warrant of attachment, which had been issued in an action, brought by the beneficiary against the issuer of the letter of credit, on the ground that the complaint did not state a cause of action, was granted, although the plaintiff presented affidavits in support of the warrant tending to show that Java white granulated sugar was not only known in the market as Java white sugar, but was the only white sugar shipped from Java. Upon this subject the court said:

> It is clear that the defendant is not under obligation to investigate and ascertain whether the contract between the vendor and vendee has been fulfilled. The only contract which the defendant has made was to honor the vendor's drafts as against the bill of lading for "Java white granulated sugar."

In International Banking Corporation v. Irving National Bank, the letter of credit authorized drafts to be drawn "against complete negotiable set of shipping documents covering 500 pieces Fuji silk . . . total width of stripes not more than 50% of the material width." The documents required were negotiable bills of lading, insurance certificates, consular invoice, and commercial invoice. There was no statement in any of the documents presented that the stripes were not more than 50 per cent of the material width. For this reason the defendant, the issuing bank, refused to pay the drafts drawn under the letter of credit; and its action was sustained by the court.

In that case the issuing bank, perhaps by inadvertence, had incorporated in its letter of credit certain of the terms of the underlying contract of sale. As intimated in the

opinion of the court, this is likely to lead to complications. The letter of credit should provide simply for payment against standard documents, in a form with which bank clerks are familiar and which they clearly understand.

In the very recent case of Diamond Alkali Export Corporation v. Bourgeois, a sales contract was under consideration and not a letter of credit. However, the case is important, as it defines certain terms, which are constantly used in letters of credit. The contract provided for payment by cash against documents, including bills of lading and insurance policies, under confirmed bankers' credit at London, price c.i.f. Gottenburg. The bill of lading was not in the old familiar form, acknowledging that the goods had been "received on board," but read "received in apparent good order and condition . . . to be transported by the steamship 'Anglia,' now lying in the port of Philadelphia . . . or, failing shipment by said steamer, in and upon a following steamer." No policies of insurance were tendered, but only a certificate that the goods were insured under a policy which was not tendered. The buyers having rejected the documents, the sellers brought this action for damages. Justice McCardie, in holding that the document tendered was not a bill of lading, such as had been contracted for, said:

> From the earliest times a bill of lading was a document which acknowledged actual shipment on board a particular ship . . . Apart from any authority to the contrary, it seems to me that I must hold that the document here is not a bill of lading within the c.i.f. contract before me. It does not acknowledge the goods to be on board a specific ship, nor does it acknowledge a shipment on board at all. It leaves it uncertain as to whether the goods will come by the "Anglia" or some following ship. The word "following" is loose and ambiguous in itself . . . The document seems to me to be (in substance) a mere receipt for goods which

at some future time and by some uncertain vessel are to be shipped.

He further held that a certificate of insurance was not a good tender in England under an ordinary c.i.f. contract.

It has been held in a case decided at New York County Trial Term in March, 1921, that, under a letter of credit calling for "shipment within October 15, 1920," such a "received for shipment" bill of lading is not evidence of shipment within the time limited, where the vessel was not, at the time when the bill of lading was issued, in the Port of New York.

Vietor v. The National City Bank of New York (not yet reported).

This was an action by the seller of the goods against the issuing bank. The plaintiff contended that, under a custom claimed to prevail in the Port of New York, delivery of the goods to the carrier constituted shipment, even though they were not placed on board. This question was submitted to the jury, which, by its verdict for the defendant, found that no such custom existed. The judgment has been reversed on appeal because of error in the exclusion of evidence and the case sent back for a new trial.

As a matter of practice, the issuing bank should not call in its letter of credit for a bill of lading describing the goods by any technical terminology. The bill of lading is issued by the agents of the carrier, who do not know and are not interested in the contents of the packages delivered to them for shipment. A careful description of the goods should be contained in the *invoice* which is prepared by the seller, who knows what goods he has

shipped. If he deliberately puts a false description of his goods in his invoice, it is likely that he will be held, under the law of any jurisdiction, to have committed the crime of obtaining money under false pretenses. Consequently the letter of credit should require that the drafts are to be accompanied by "bills of lading for merchandise, invoice to read," followed by whatever technical description of the goods may be desired.

II. The Issuing Bank Is Not Responsible for Genuineness of Documents Tendered

Suppose, under a letter of credit providing that payment will be made against bill of lading, invoice, and insurance certificate, that the bank pays against documents, apparently complying with these requirements, but which are in fact forged and worthless, who must bear the loss? It is held that the bank does not guarantee the genuineness of the documents, and that, if it pays in good faith against documents which are valid on their face, it is protected, even though the documents are forged. In that event, the purchaser must look for his remedy to the guilty parties.

Woods v. Thiedemann, 1 H. & C. 478.
Ulster Bank v. Synnott, Irish Rep. 5 Equity 595.
Guaranty Trust Co. v. Hannay, 87 L. J. K. B. 1223, 1229.
Springs v. Hanover National Bank, 209 N. Y. 224; 103 N. E. 156.

On the other hand, if the bank pays against documents which it knows to be forged, or in case it is chargeable with notice of that fact, the bank should not be protected in making the payment.

Union Bank of Canada v. Cole, 47 L. J. C. P. 100.

In one English case it was held that a bank was not protected when, under a letter of credit requiring, among other documents, an insurance policy, it honored drafts accompanied by a policy of insurance which was not broad enough to cover the risk of certain injuries actually suffered by the goods when on board ship.

Borthwick v. Bank of New Zealand, 17 T. L. R. 2.

On principle, it would seem that, if the letter of credit required insurance against all risks, a bank negotiating drafts against insurance policies which did not cover all risks should be held liable for loss resulting. If, however, the letter of credit merely calls for insurance without specifying what form of insurance is required, it would seem that the bank should be protected, if the seller placed such insurance as is customary at that time and place. The question as to what is such customary insurance is a question of fact; and in the case last cited, evidence was given that the defendant had not taken the customary insurance.

III. The Bank Is Not Responsible for the Character or Quality of the Goods

Under a letter of credit authorizing a bank to pay against specified documents covering goods of a character or quality named, it seems to be settled that the bank must pay if the specified documents describe the goods as of the required character and quality. The bank is not required to go behind the documents and inspect the goods; and it would seem that it has no right to do so. All the parties contemplate that payment must be made against the documents; and no duty can be imposed upon the bank to inspect or test the goods in the absence of an express agree-

ment to that effect. No doubt the parties to such a transaction might agree that the bank should inspect and test the goods if they chose; but a bank would be going outside the bounds of ordinary banking business if it should undertake to do this. While its clerks and employees are presumed to be familiar with the ordinary documents tendered under a documentary letter of credit, they are usually totally unfamiliar with the goods which are the subject of the sale; and an inspection of the goods by them would be of no benefit to anyone. If the buyer desires an inspection before he pays for the goods, that can be accomplished by a provision in the letter of credit, specifying a certificate of inspection or quality, executed by someone in whom he has confidence, as one of the documents against which payment must be made.

In various cases efforts have been made to hold the bank liable for defects in the quality of the goods or deviation in their character from that agreed upon, but without success.

Basse & Selve v. Bank of Australasia, 90 Law Times Rep. 618.

Benecke v. Haebler, 38 App. Div. (N. Y.) 344, 347; aff'd 166 N. Y. 631; 60 N. E. 1107.

In Basse v. Bank of Australasia a documentary credit required a certificate of analysis, showing that the ore shipped contained not less than 5 per cent of a certain element. The beneficiary gave such a certificate, which was correct on its face but was false in fact. In an action by the buyer against the bank which issued the credit, and had paid the drafts drawn thereunder, the court gave judgment for the defendants saying:

It would be no part of the bank's duty to see to the sampling or to ascertain that it was fairly done. The bank was entitled to

assume that it was so, just as they were entitled to assume that the analyst had acted skilfully in making the analysis. The certificate is, in my opinion, regular on its face, and comes within the meaning of the mandate under which the bank was acting, and the bank in taking it acted properly and carefully.

In Benecke v. Haebler, the plaintiff, having issued a documentary letter of credit, honored the drafts drawn thereunder, the documents being in conformity with the letter of credit, although the defendant, the purchaser of the goods, claimed that the goods did not comply with the provisions of the contract of sale between him and the beneficiary of the credit. In an action by the issuing bank to recover from the purchaser the amount of its disbursements, judgment was given for the plaintiff. The court said:

I cannot see that the fact that the beans sent forward by Strauss were inferior in quality to those contracted for at all affects the question of the defendants' liability for moneys paid by the plaintiffs in discharge of an obligation assumed by them at the defendants' request. The kind or quality of the beans to be shipped by Strauss was not defined in the defendants' letter asking for a credit, and no duty devolved upon the plaintiffs to ascertain, before accepting, whether the goods shipped corresponded in quality with the goods ordered.

In International Banking Corporation v. Irving National Bank (274 Fed. 122), already referred to, the letter of credit described the silk, which was the subject of sale, in detail, in accordance with the description contained in the sale contract. The documents tendered did not show that the silk conformed with these requirements, and it was held that the issuing bank was not liable upon its letter of credit. The court, by way of dictum, referred to the matter of inspection by the bank as follows:

When the bank issued this letter of credit it did not purchase the goods. It agreed to purchase documents in the sense that it would pay upon receipt of certain documents, which should conform in every respect with the requirements of the letter of credit. It was, of course, not concerned with the goods but with the documents . . . The only safe rule for a bank is to refuse to pay, if, by omitting, as here, a distinct and clearly expressed provision, the documents do not conform with the letter of credit.

IV. The Bank Is Not Concerned with the Provisions of the Sale Contract Not Incorporated in the Letter of Credit

It is now well settled that the letter of credit is an entirely distinct contract from the underlying contract of sale, in aid of which it is issued. The bank is liable only upon its letter of credit and is not concerned with or bound to enforce any of the provisions of the sale contract, which are not incorporated in its letter of credit.

Maitland v. Chartered Mercantile Bank of India, etc., 38 Law Jour. Rep. 363.
Gelpcke v. Quentell, 74 N. Y. 599.
American Steel Co. v. Irving National Bank, 266 Fed. 41.

In a falling market, such as has recently prevailed, a buyer is tempted to seek some pretext for refusal to pay and a seller, who is unable to perform his contract, is equally tempted to make a shipment which does not comply with its provisions, in the hope that he may be paid under the letter of credit. These conditions make the position of the bank, which desires to carry out its credit contract in good faith, a very difficult one, since it is bound, at its peril, to determine correctly the respective rights of the buyer and seller under the letter of credit.

During the past year scores of actions were instituted

by buyers in New York against their vendors and the banks to enjoin the beneficiaries of their letters of credit from drawing drafts thereunder and to enjoin the banks from paying such drafts, if drawn. In none of these cases was this relief granted, the courts uniformly holding that the bank must pay in accordance with the terms of the letter of credit and that the buyer must look for his remedy to an action upon his contract of sale.

Frey & Co. v. The National City Bank, 193 App. Div. (N. Y.) 849, 853.
Gambrill Manufacturing Co. v. American Foreign Banking Corporation, 194 App. Div. (N. Y.) 425.
Shapiro Candy Company v. Reiter, 64 N. Y. Law Jour., 885 (Dec. 13, 1920).
Norma Chocolate Co. v. Leavitt, 194 App. Div. (N. Y.) 975.
El Reno Grocery Co. v. Lamborn, 64 N. Y. Law Jour. 908 (Dec. 15, 1920).
Williams Ice Cream Co. v. Chase National Bank, 64 N. Y. Law Jour. 1141, (Jan. 4, 1921).
Penn Milk Products Co. v. Laborn, 64 N. Y. Law Jour. 1141, (Jan. 4, 1921).
Central Sugar Co. v. Lamborn, 195 App. Div. (N. Y.) 904.
Ideal Cocoa & Chocolate Co. v. De Megalhaes, 64 N. Y. Law Jour. 1324, (Jan. 18, 1921).
Sun-Herald Corporation v. Maurice O'Meara Co., and Sun Printing & Publishing Co. v. Ronconi, 64 N. Y. Law Jour. 1426, (Jan. 26, 1921).

In the Frey case, the Appellate Division, First Department, said:

The bank issuing the letter of credit is in no way concerned with any contract existing between the buyer and seller. The bank may only be held liable in case of a violation of any of the terms of the letter of credit. It would thus follow that if the bank paid any drafts violative of the terms of the letter, the buyer would have recourse to the bank in an action for damages for the breach of its contract. Similarly, if the defendant Sherburne

Company violated its contract with the plaintiff, the latter has a remedy in an action at law for damages against the defendant . . . It would be a calamity to the business world if, for every breach of a contract between buyer and seller, a party may come into a court of equity and enjoin payment on drafts drawn upon a letter of credit issued by a bank which owed no duty to the buyer in respect of the breach. The parties should be remitted upon their claims for damages to an action at law.

V. Notice to Beneficiary of Revocation of a Revocable Credit

There is very little authority as to the nature of revocable credits or of the obligation created thereby. This depends primarily, of course, on the language used by the issuing bank in the advice given to the beneficiary. Some banks give notice with a revocable credit that it is subject to revocation at any time, and, that, in the absence of any statement to the contrary, the bank assumes no obligation whatever to make the payment, even if all the conditions of the credit have been complied with.

Under such a form, which expressly states that no obligation is created, it is difficult to see how the issuing bank is under any obligation to give the beneficiary notice of the revocation of the credit, although, of course, it would be courteous and considerate to do so. The beneficiary is advised at the outset that he has no binding obligation, and that anything he does in reliance on the credit is done at his own risk. If he chooses to proceed without having the credit made irrevocable, he should bear the consequences.

However, not all revocable credits contain as explicit a warning clause as that above referred to. In a recent English case, the credit contained, apparently, only the following clause on this subject:

This is an advice of the opening of the credit and is not to be taken as a confirmation of same.

The credit was withdrawn by the foreign bank, but the English bank, which had advised it to the beneficiary, inadvertently failed to notify him of its withdrawal. The beneficiary proceeded in reliance on the credit and two months later tendered documents under the credit. It was held that the issuing bank, which refused to pay the drafts drawn under the credit, was not liable to the beneficiary, since the bank was under no obligation to give notice of the revocation.

Cape Asbestos Co. Ltd. v. Lloyds Bank, King's Bench Commercial Court, Bailhache, J. (not yet reported).

That decision, however, was also placed upon the additional ground that the documents tendered to the bank by the beneficiary were not those called for by the credit.

A revocable credit undoubtedly creates a totally different relation between the issuing bank and the beneficiary than that created by an irrevocable credit. The beneficiary knows from the start that the credit may be revoked at any time. There is no obligation enforcible against the bank, certainly before the beneficiary has tendered the documents called for by the credit. It might be contended, however, that, although the credit is *revocable,* it stands until it is actually *revoked;* and that it cannot be effectively revoked until notice of the revocation is given to the beneficiary, the one primarily interested. This contention would imply that the unrevoked credit was a continuing offer, which, upon acceptance by tender of the proper documents, ripens into a contract.

Numerous other questions arise in connection with these credit instruments, such as the question whether

the issuing bank can honor drafts drawn against documents representing partial shipments of the goods contracted for; questions as to the rights of the parties where the bank, having paid the drafts and received the documents, releases the goods to the purchaser under a trust receipt; questions in regard to the measure of the damages which the holder of the letter of credit may recover against a bank which refuses to honor drafts drawn under and in conformity with its irrevocable letter of credit; and the question as to the liability of the drawer of a draft, drawn under an irrevocable letter of credit, in case the draft is not honored. On many of these subjects there is a dearth of authority at the present time; but there will undoubtedly be numerous decisions in the near future in which the rules which are applicable will be declared.

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